

# DISCLOSURE OF POLITICAL ACTIVITIES OF TAX- EXEMPT ORGANIZATIONS

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## HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES ONE HUNDRED SIXTH CONGRESS SECOND SESSION

—  
JUNE 20, 2000  
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## **DISCLOSURE OF POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS**

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**TUESDAY, JUNE 20, 2000**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
SUBCOMMITTEE ON OVERSIGHT,  
*Washington, D.C.*

The Subcommittee met, pursuant to call, at 2:03 p.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

# ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE,  
June 8, 2000  
No. OV-19

Contact: (202) 225-1721

### **Houghton Announces Hearing on Disclosure of Political Activities of Tax-Exempt Organizations**

Congressman Amo Houghton (R-NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on proposals for enhanced public disclosure relating to political activities of tax-exempt organizations. **The hearing will take place on Tuesday, June 20, 2000, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

Oral testimony at this hearing will be from both invited and public witnesses. Invited witnesses will include a representative of the U.S. Department of the Treasury. Also, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

#### **BACKGROUND:**

Under current law, various tax-exempt organizations participate in the political process. Depending on the tax law provision granting a particular organization its exemption, that participation can include direct or indirect intervention in political campaigns, direct or grass-roots lobbying, and dissemination of analyses with a call to action. The public often has little or no information regarding the contributors to, or the nature and extent of, the political activities of these organizations.

The Internal Revenue Service Restructuring and Reform Act of 1998 (P.L. 105-206) directed the Joint Committee on Taxation and the Treasury Department to report on additional disclosures by tax-exempt organizations that would be in the public interest. The Joint Committee's report was delivered in January of this year as required and makes a number of recommendations for enhanced disclosure of tax-exempt organization political activities. The Treasury Department has yet to submit its report.

In announcing the hearing, Chairman Houghton stated: "The public is entitled to know about the activities of organizations given special tax-exempt status by our laws. Unfortunately, current laws permit various organizations to shield their political activities from public scrutiny and accountability. This hearing will explore options for providing increased disclosure by all tax-exempt organizations participating in the political process."

#### **FOCUS OF THE HEARING:**

This hearing will examine various proposals for enhanced disclosure relating to the political activities of tax-exempt organizations, including organizations described in Internal Revenue Code sections 501(c)(4), (5), and (6) and section 527.

#### DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Pete Davila at (202) 225-1721 no later than the close of business, Tuesday, June 13, 2000. The telephone request should be followed by a formal written request to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Oversight will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee on Oversight staff at (202) 225-7601.

**In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard.** Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, of their prepared statement for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Oversight office, room 1136 Longworth House Office Building, no later than Friday, June 16, 2000.** Failure to do so may result in the witness being denied the opportunity to testify in person.

#### WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label*, by the close of business, Wednesday, July 5, 2000, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, by close of business the day before the hearing.

#### FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or para-

phrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman HOUGHTON. The hearing will come to order. Good afternoon, ladies and gentlemen. We are here to discuss today how political activities by tax-exempt organizations are disclosed to the American public. The headlines usually focus on Federal election law. But on a taxwriting Committee, we are concerned about the obligation of tax-exempt groups to operate in the sunshine.

I believe that the best way to handle political activities by tax-exempt organizations is to minimize regulation and to maximize disclosure.

As with my constituents, and everyone I am sure in this room, I read newspapers and see ads on television about political races. It is difficult to know what to make of an advertisement without knowing who is behind it, who is paying for it.

When it comes to the public's right to know who is doing or saying what, it makes no difference whether an organization is tax-exempt under section 501(c) or under section 527 of the Internal Revenue Code. We need disclosure by section 527 organizations, but when 501(c) groups intervene in the political process they also should disclose what they are doing and who is paying. We cannot shy away from the task of striking a balance between the rights of individuals and groups to participate in the political process and the public's right to know, just because it is a difficult process.

So I am pleased that several of my colleagues, the Treasury Department, the Joint Committee on Taxation, and several academics and election law attorneys will be giving us the benefit of their best thinking. Your insights will be helpful to us as we try to come to terms with this issue before the July 4 break.

I am pleased to yield to my friend and colleague, Mr. Coyne, for any comments he would like to make.

Mr. COYNE. Thank you, Mr. Chairman. I welcome these hearings and I hope they will lead to the enactment of legislation that will



provide the public with information on the activities and funding sources of Tax Code section 527 political organizations. We do not know how many tax-exempt 527s exist today. These entities are not required to apply for tax exemption with the Internal Revenue Service or to report their financing or their activities, less in rare instances some net investment tax is due.

Similarly, the public does not know who or what special interest is behind the issue ads that these organizations run in newspapers or on television. These political slush funds, as they have become known, undermine our election process and our tax-exempt laws. There is a simple way of preventing abuse by these organizations. Let the public know the truth about section 527 organizations, their purpose, funding sources, and political activities.

I commend Subcommittee Chairman Houghton for his leadership on this issue. Today's hearing was organized by a bipartisan group of people and we did this with the goal of providing a hearing record which will support full public disclosure of organizations involved in political activities. I hope that the bipartisanship that went into selecting today's witness list that is with us today will continue.

H.R. 4168 is within the jurisdiction of the Ways and Means Committee and provides a targeted and fair solution to the problem. The Doggett bill, sponsored by Congressman Lloyd Doggett, would merely require Code section 527 political organizations to file publicly disclosable reports, including the names of contributors and expenditures, with the IRS. The bill is designed to mirror the filing and disclosure rules that political parties and campaign Committees must follow under Federal election laws administered by the FEC. The penalties for noncompliance mirror the existing Tax Code penalties applicable to other exempt organizations that fail to file required returns or to provide the public with full disclosure.

The substance of H.R. 4168 has been before the Committee for a vote twice and on the floor for a vote twice. In each instance, the legislation was defeated by the Majority party leadership. It is time to end the political games and have disclosure reforms enacted into law. This should be done before the upcoming elections in November.

The Senate has approved on a bipartisan basis the legislation supported by House Democrats. As Senator McCain said on the Senate floor on June 8 of this year, and I quote, "There isn't an American who is well informed who does not know that this system has lurched completely out of control when people are allowed to engage in the political system and give unlimited amounts of money and have it undisclosed."

In conclusion, I understand that the Committee will be marking up Chairman Houghton's disclosure bill later this week and that the Republican leadership intends to bring a disclosure bill to the floor before the July 4 recess. Everyone agrees that the abuse of our tax and election laws by section 527s is growing and it must be stopped. The only question is when, and I hope that we will do that now. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much.

If any of the other members of the panel have statements to make, if they could make them rather briefly because we have got a lot of work to do this afternoon. Have you got anything?

Mr. McNULTY. I will make it very brief, Mr. Chairman. I am a cosponsor of the Doggett bill. I associate myself with the remarks of Congressman Coyne and I look forward to hearing from these distinguished panels.

Mr. HAYWORTH. Mr. Chairman, I just want to welcome the first panel, especially my senior Senator. I look forward to hearing the testimony and getting to work on truly full disclosure. I am especially interested in Governor Castle's take on this.

Mr. LEWIS of Georgia. Thank you very much, Mr. Chairman. Mr. Chairman, I am pleased that you called this hearing today on section 527, political organizations. I look forward to working with you on a bipartisan basis to address the mess created by these organizations.

I also want to thank our first panel witnesses for testifying today and for all their hard work on this important issue. In particular, I want to commend my good friend and colleague, Lloyd Doggett, for his effort to close the 527 loophole. I am a strong supporter of his bill, H.R. 4168.

Every person in America realizes the importance and the necessity of fixing our system of financing elections. Closing the 527 political organization loophole is an important step toward that goal. These organizations can take unlimited money, almost from any source, even foreign money, and make expenditure without any disclosure to anyone. It is a sham, it is a shame, and it is a disgrace.

H.R. 4168 will require simple disclosure by these secretive political organizations. The American people have a right to know. They have a right to know who is funding political campaigns in this country. They have a right to know who is behind attack ads. The American people have a right to a free and fair election process. It is time to close this loophole.

Again, Mr. Chairman, I commend the efforts of Senators McCain and Lieberman for getting the amendment passed in the Senate. I hope this hearing is a step toward the House also passing legislation to close this loophole. Mr. Chairman, I look forward to working with you on this important issue and again I want to thank you for having the vision and the stick-to-it-tiveness and dedication toward holding this hearing. Thank you very much.

Chairman HOUGHTON. Thanks very much, Mr. Lewis.

Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman. So we can get to our witnesses quicker, I would like to ask unanimous consent to insert my comments in the record and thank all you gentlemen for the hard work you have done on what I think could be a very important disclosure law if we can make this work. I yield back.

[The opening statement of Mr. McDermott follows:]

**Opening Statement of Hon. Jim McDermott, a Representative in Congress from the State of Washington**

Mr. Chairman, Thank you for holding this hearing, I am anxious to delve into this issue here and at the full committee later this week. Mr. Chairman, the ideals of Jefferson and Madison, that any citizen may contest the offices that we hold, are under siege. It may seem dramatic to invoke the founding fathers today, and I do not do it lightly, however the problems of campaign finance reform are dramatic

ones. The premise of a republic is that all citizens have a voice in their government. And yet, with each cycle, we see that our system is increasingly becoming one where only the very wealthy have that voice, and the poor and middle classes are effectively consigned to the political bleachers.

The issues of campaign finance reform are complicated and contentious, and we will not address all the issues here today. However, by addressing the organizations that operate under section 527 of the tax code, we have chosen to investigate some of the most egregious excesses in the system. There are many legitimate organizations that have used this tax law for many years. However, recently, there has been much attention spent on the organizations who seek to exploit section 527 in their efforts to funnel massive amounts of money into politics, bypassing the letter and the spirit of campaign finance laws. I am looking forward to tackling this issue and bringing more transparency and accountability to these "527 organizations".

I would like to commend my colleague and friend from Texas, Mr. Doggett, for his work on this issue. I would also like to add that I hope that this is the start of a series of campaign finance reform measures, such as soft money, that the Ways and Means Committee addresses, and not the annual attempt to "fix the system". Thank you.

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Chairman HOUGHTON. Thank you. We have got a star-studded panel out here. We are appreciative of your being here. Lloyd, would you start? Mr. Doggett.

**STATEMENT OF HON. LLOYD DOGGETT, A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF TEXAS**

Mr. DOGGETT. Thank you very much, Mr. Chairman, for your consistent courtesy and fairness, you and Mr. Coyne and the Members of the Committee. Before I made my first speech this year of many on 527s, I made an appeal to all Members of this Committee and to the Republican Caucus to make the cleanup of the worst excesses of the campaign mess a bipartisan endeavor. Though that initial offer was not successful, I remain very hopeful that given the tremendous interest and good intentions of Chairman Houghton, the significant success of Senators McCain, Lieberman, and Feingold, and securing Senate approval of 527 legislation as well as the active and very constructive participation of our colleague Mike Castle, that we can yet produce a bipartisan victory for reform in time for this year's election.

I would respectfully suggest that achieving modest but meaningful reform that can actually be approved now should be the overriding concern of this Subcommittee. In short, what can we do now that will make this year's election a little bit cleaner? If we do not recommend legislation that can be approved and effective immediately, no matter how perfect it might be, I don't believe we will have accomplished anything meaningful.

In that regard, I am pleased that Chairman Houghton has worked with Chairman Archer to schedule a markup of this legislation the day after tomorrow, and that Mr. Castle and others who might otherwise have supported my recent motion to recommit have been successful in securing a public pledge from the House leadership, voiced on June 9 by Majority Leader Armey who previously testified to this Committee that action on 527s was unnecessary, that we will now be voting on this important issue next week.

That pledge must be fulfilled with a fair rule for bipartisan legislation that permits reasonable debate and a vote to send this legis-

lation to the Senate so that they can consider it shortly after the July 4 recess.

Time is strongly on the side of those who insist on obstruction. We must not permit them to run out the clock on reform this year.

As a starting point for prompt action on this very tight timetable, I recommend that you consider H.R. 4168, the Underground Campaign Disclosure Act, which now has over 200 House cosponsors. The language for the previous amendments and motions that I have offered has been drawn from this measure that I filed in April. The bill is quite similar to the 527 amendment adopted in the Senate. They have got a couple of things that I think ought to be in this measure, and I have got a few that are in mine that are not in theirs that I think are worthy of consideration.

The first of those is the requirement, not in the Senate amendment, for electronic filing with immediate public disclosure. A second advantage is directed to the concern that I know you have, Chairman Houghton, that we have comprehensive coverage. I would require disclosure of whether 527 contributions are coordinated with a candidate's agents or Committee as well as disclosure from any non-person or entity, such as a 501(c)(5) union or a 501(c)(6) association that is donating to a 527. This disclosure would include identifying information such as business purpose and tax status.

A third advantage that I believe my language contains relates to penalties. I believe that we need the filing and disclosure penalties contained in the Internal Revenue Code section 6685 and 7207 with regard to failure to file or filing false documents, and I have also applied the gift tax. The latter has served as a deterrent to the misuse of 501(c)(4) organizations and the lack of an existing gift tax deterrent for 527 groups is apparently one of the reasons that so many interests prefer 527s. The Senate amendment offers a couple of desirable features that I have not included that I hope you will include—the filing of the initial notice shortened to 24 hours and the requirement that an electronic address be included as well.

During the last 3 months, at the same time that those in the House who are dependent on secrecy have been able to block disclosure, they have been able to raise and spend unlimited amounts of money to influence this year's election. That reality, continuing to seek more and more money from hidden donors even as we gather here in a bipartisan fashion this afternoon, demands one further improvement in this legislation. Any effective reform bill will require that those involved in the money chase this year disclose where they found the money. The effective date provision should require that organizations report on transactions since the beginning of this tax year. Without such language, there will be a mad race to collect more secret money just before the disclosure bill is signed into law, after which we will only learn that the 527 has a huge amount of cash on hand but not from whence it came.

Finally, 527s have been properly called the high-performance soft money. The ability to raise unlimited, undisclosed, unaccountable amounts of money have really made them the political super-weapon of this year.

RMIC is not just the sound of a frog. It is also the acronym for a Committee spearheaded by Mr. DeLay which reportedly has targeted donors interested in giving half a million to 3 million dollars each. I don't seek to limit his activities in any way, or that of any other interested person; only to require that he report, as all of us must do, individuals who gave, how much, and for what.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks very much, Mr. Doggett.

[The prepared statement follows:]

**Statement of Hon. Lloyd Doggett, a Representative in Congress from the State of Texas**

Before I made my first speech on 527's, I made an appeal to all members of this Committee and to the Republican caucus to make the cleanup of the worst excesses of this campaign mess a bipartisan endeavor. Though that initial offer was not successful, I remain hopeful that the tremendous interest and good intentions that you have voiced, Chairman Houghton, combined with the success of Senators McCain, Lieberman, and Feingold in securing Senate approval of 527 legislation as well as the active participation of our colleague Mike Castle can yet produce a bipartisan victory for reform in time for this year's election.

I believe achieving modest but meaningful reform that can actually be approved now must be the overriding concern of this Subcommittee—what can we do that will make this year's election a little cleaner? If we do not recommend legislation that can be approved and effective immediately, we will have accomplished nothing worthwhile.

In that regard, I am pleased that Chairman Houghton has worked with Chairman Archer to schedule a markup on this legislation the day after tomorrow. Moreover, Mr. Castle and others, who might otherwise have supported my recent Motion to Recommit, have been successful in securing a public pledge from the House Leadership voiced on June 9 by Majority Leader Armey, who had previously testified to our Committee that action on 527's was unnecessary, that we will now be voting on this issue next week. That pledge must be fulfilled with a fair rule for bipartisan legislation that permits reasonable consideration of alternatives and a vote to send legislation that the Senate can consider for action after the July 4 recess. Time is strongly on the side of those who insist on obstruction; we must not permit them to "run out the clock" on reform.

As a starting point for prompt action on this timetable, I recommend that you begin with HR 4168, The Underground Campaign Disclosure Act, which now has over 200 cosponsors. The language for the previous amendments and motions I have offered has been drawn from this measure that I filed in April. This bill is quite similar to the 527 amendment adopted in the Senate. It offers an advantage over the Senate amendment in requiring electronic filing with immediate public disclosure. A second advantage is directed to the concern that I know you have Chairman Houghton for comprehensive coverage. I would require disclosure of whether 527 expenditures are "coordinated with a candidate, agent, or committee;" as well as disclosure from any non-person (or entity) such as a 501(c)(5) union or a 501(c)(6) association that is donating to a 527. This disclosure would include identifying information, including tax status and business purpose. A third advantage relates to penalties. I believe it is important to include the existing filing and disclosure penalties to which other tax-exempts are subject under IRC § 6685 (relating to willful failure to comply with public inspection requirements) and § 7207 (relating to willfully filing false or fraudulent documents). I have also sought to apply the gift tax. The latter has been a deterrent to the misuse of 501(c)(4) organizations and the lack of an existing gift tax deterrent for 527 groups is apparently one of the reasons so many special interests prefer them over (c)(4)'s.

The Senate amendment offers two desirable features that I had not included, but favor: filing of the initial notice is shortened from my 10 days to 24 hours, and that notice must include an electronic address, certainly a necessity in today's world.

During the last three months at the same time those in this House dependent on secrecy have been able to block disclosure, they have continued to raise and spend unlimited amounts of money to influence this year's election. That reality—continually seeking more and more money from hidden donors—even as we gather here this afternoon, demands a further improvement in 527 legislation. Any effective reform bill will require those involved in the money chase this year to disclose where they have found it. The effective date provision should require that organizations

report on transactions since the beginning of this tax year. Without such language, there will be a mad race to collect more secret money just before a disclosure bill is signed into law, after which we will only learn that the 527 has a huge amount of cash on hand but not from whence it came.

527's have been properly called "high performance soft money." The ability to raise unlimited, undisclosed, unaccountable amounts of money has made 527's the political superweapon of the 2000 elections. RMIC is not just a sound of a frog; it is also the acronym for a committee, spearheaded by Mr. DeLay, which reportedly has targeted donors interested in giving half a million to three million undisclosed dollars *each*. I don't seek to limit any of his activities—only to require that he report as all of us do who gave, how much, and for what.

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Chairman HOUGHTON. Senator McCain.

**STATEMENT OF HON. JOHN McCAIN, A UNITED STATES  
SENATOR FROM THE STATE OF ARIZONA**

Senator MCCAIN. Thank you very much, Mr. Chairman. I would ask that a statement by Senator Feingold, who sponsored this legislation with Senator Lieberman and me, be made part of the record.

Chairman HOUGHTON. Without objection.  
[The prepared statement follows.]

**Statement of Hon. Russ Feingold, a United States Senator from the State  
of Wisconsin**

I am very pleased that the subcommittee is holding this hearing. This is an extremely important topic for the future of our campaign finance laws, and for the confidence of the American people in their elected officials. We need to act quickly to end the secrecy that so-called 527 organizations and those that act through them now enjoy. I commend the Members of the House and Senate who have seen the need to act in this area and have worked so hard to make sure the issue gets the attention it deserves. In particular, my colleagues Senators Lieberman, Levin, and McCain deserve a great deal of credit for leading the fight on this issue in the Senate, where we won an important, and to some surprising, victory a few weeks ago.

I hope that the Ways and Means Committee and the full House will promptly pass a bill that, if nothing else, will end the veil of secrecy behind which 527s now hide. There is of course, much more that can and should be done on the campaign finance issue generally and to strengthen disclosure in particular. I note with pride that the chairman of this subcommittee is a strong supporter of the Shays-Meehan campaign finance reform bill. I am confident he will act to make sure that the views of reformers are heard during the upcoming House consideration of this disclosure issue. I want to make it very clear that none of us who support reform are under any illusion that a positive resolution of the 527 problems is all that needs to be done to cure the ills of the campaign finance system. It is a crucial first step, but only a first step. Our fight in the Senate for more far reaching reform, including a ban on soft money, will continue.

At the same time, we cannot let our desire for more sweeping reform, or for broader disclosure, prevent us from dealing with the 527 problem in this Congress, and hopefully in the next few weeks. 527s are the only groups not affiliated with candidates or parties whose reason for being is to influence elections. And 527s are the only entities involved in the political process that can operate entirely in secret. Something has to be done about this right away. The American people have a right to know who these groups are, what they are up to, and who is funding them. There is no justification for secret money in elections.

These 527 groups are now openly and proudly flouting the election laws by running phony issue ads and refusing to register with the FEC as political committees or disclose their spending and contributors. It is time that Congress called a stop to this, not to try to keep anyone from speaking or otherwise participating in elections, but to give the American people information that they desperately need and deserve about who is behind the ads that already flooding our airwaves, six months before the election.

There is no reason that our tax laws should give protection to any group that refuses to play by the election law rules. For that reason, I have cosponsored and

wholeheartedly endorse S. 2582, a bill introduced earlier this year by Senators Lieberman, Levin, McCain, and others to restrict the tax exempt status available under section 527 of the Internal Revenue Code only to those groups that register and report with the FEC. But at the very least, the public deserves more information on the financial backers and activities of groups that benefit from this tax exempt status, and that is what the amendment we passed in the Senate a few weeks ago attempts to provide.

Time and time again when we debate reform on the floor of the Senate, the opponents of the McCain-Feingold bill say that they favor full and complete disclosure of campaign contributions and spending. All members of Congress who confidently proclaim that full disclosure is the answer to our campaign finance problems should realize that they cannot be consistent in that view if they don't support this bill to require disclosure by 527s. All we seek now, with respect to the 527s that are spending millions of dollars to influence elections, is disclosure, the most basic and common sense component of our campaign finance laws. It is said that sunshine is the best disinfectant. Here is our chance to throw some sunshine on this latest effort to cast a dark cloud on our campaign finance system.

We know that many members of Congress are involved in raising money for 527s. Recently, there was a very disturbing report in the *Washington Post* about the Senate Majority Leader urging hi-tech companies to contribute to a new group called Americans for Job Security that is now running ads supporting one of our colleagues who is up for reelection. Americans for Job Security is almost certainly claiming a tax exemption under section 527, but at the same time it will not disclose its contributors or its spending. And we all know of the highly publicized connections between the Majority Whip in the House, Mr. DeLay, and various 527 organizations.

These groups pose a special danger to the political process. If members of Congress can organize them or raise money for them, the real possibility of corruption emerges. What is the difference between a million dollar contribution directly to a candidate and a million dollar contribution requested by a candidate that plans to run ads to support that candidate or, more likely, attack his or her opponent? There really is no difference when you come right down to it. Right now, however, the first contribution is illegal, as it should be, and the second contribution is not. Our amendment doesn't prohibit that second contribution, it just asks that it be made public.

As groups proliferate, the chances of scandal increase as well. It won't be long before reports of legislative favors received by big donors to 527 groups start making the headlines. Or foreign money, or money derived from organized crime, making its way into our election process by way of 527s. The 527 loophole is a ticking time bomb of scandal.

Money, politics, and secrecy is a dangerous mixture. The least we can do is address the secrecy ingredient in this potion. There is no justification whatsoever for allowing these groups to operate under the radar. Citizens deserve to know who is behind a message that is being delivered to them in the heat of a campaign. These groups that hide behind apple pie names are trying to obscure their identities from the public. The public is entitled to that information. And it is entitled to withhold a tax exemption from any group that refuses to provide the information.

One of the questions that is going to be examined in this hearing and in the coming days prior to the promised House vote before the July 4th recess is whether the disclosure we seek of 527s should be required of other actors in the political process. I believe it should, but I must caution this subcommittee. Our amendment dealing with 527s is absolutely fair and balanced. And it is constitutional. Any additional disclosure that we seek from others must also be balanced, and constitutional. If you're going to cover labor, you have to cover business, including for-profit corporations. And if you're going to cover those groups you really need to look at advocacy groups that received a tax exemption under section 501(c)(4) of the tax code.

The question of requiring disclosure by 501(c)(4)s raises special concerns. The principle of freedom of association, long recognized by the Supreme Court as a critical component of our First Amendment freedoms, prohibits the government from seeking the membership list of organizations that are engaged in public advocacy.

I believe if we limit the disclosure of both expenditures and contributors to public communications that mention candidates close to an election we can overcome those constitutional concerns. A recent study of advertisements shown during the 1998 elections found that a very, very small percentage of ads that mentioned candidates in the 60 day period before an election were actually true issue ads instead of election ads dressed up as issued ads.

Congress has the constitutional power, I believe, to require disclosure by groups running such ads to protect the integrity of the election process and provide information to voters on who is behind the messages that are attempting to influence

their votes. At the same time, any disclosure provision that seeks information from advocacy groups engaged in true issue advocacy must give the group the option of making the expenditures that will be disclosed from a separate account or fund and disclosing only the contributors to the fund. Such a provision would allow groups to keep their general membership list confidential, which the Supreme Court has said is their right.

Once again, Chairman Houghton, I thank you for holding this hearing and I urge you and the Ways and Means Committee to act expeditiously to at the very least close the 527 loophole this year.

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Senator MCCAIN. I thank you and Congressman Coyne and distinguished Members of this Subcommittee. I will be brief, uncharacteristically. When Senators Feingold, Lieberman, and I initiated debate on this matter on the Senate floor, I began that discussion with quotes from two different newspapers that have divergent views but on this matter agree.

On July 13, 1998, the Wall Street Journal, in an editorial that derided broader campaign finance reforms, specifically made the following observation: "this week the House begins debate on campaign finance reform. If there is one thing all the players agree on, it is the need for better disclosure of contributions and a crackdown on violators."

the New York Times recently noted, quote: "all candidates and office holders have an ethical duty to fully disclose their campaign finance activities and to abide by contribution limits designed to protect the political system from corruption. These are basic principles that lawmakers should be able to agree upon and quickly." Simply put, disclosure is only a first step but it is needed and long overdue.

As that process continues, I am hopeful that the Committee will keep the following principles in mind. First, the legislation needs to be bipartisan and balanced. As such, it should affect both Republican and Democrat groups alike. Second, it must be constitutional.

Some proposals, Mr. Chairman, that are being discussed raise constitutional questions. These questions must be dealt with before we pass any such legislation. We must not in haste overreach and pass a bill that is destined to be immediately struck down by the courts.

Many current proposals raise questions regarding freedom of speech, freedom of association, the right to petition the Congress, and whether the precedent set in NAACP versus Alabama is being violated. In NAACP versus Alabama, the court said that the governmental purpose for disclosure, in this case to protect the political system from corruption, must be achieved in the most narrow manner possible. By focusing just on 527s, the legislation already adopted by the Senate clearly passes constitutional muster while honing in on the most egregious examples of those seeking to avoid the public scrutiny. Unlike business and labor groups, 527 organizations tend to obscure all of their activities and source of contributions, especially those that are politically related.

We must also be careful not to demand excessive information that violates the privacy of individuals or the groups they choose to associate themselves with. For instance, the current Smith-McConnell legislation would mandate that the affected organiza-



tions disclose the names and annual salaries of virtually all employees who participate in political advocacy. This sweeping and overreaching mandate would clearly violate the right of certain individuals to participate in organizations of their choosing and I believe clashes with the NAACP Versus Alabama decision.

Further, Mr. Chairman, any bill must contain a clearly written severability clause. If any one action is found to be constitutional, the remainder of the statute must be allowed to stand.

Third, we must look responsibly to expanding legislation to cover not just 527 organizations but also to cover 501(c)(4)'s, (c)(5)'s, and (c)(6)'s. I believe this can be done constitutionally and responsibly and done in a manner that would give the public greater knowledge without harming any organization's fundraising ability.

One such proposal has been developed by Senator Snowe. I would hope the Subcommittee would closely examine that proposal and consider it as a starting position when discussing this manner.

Last, Mr. Chairman, let's not let the perfect be the enemy of the good. Greater disclosure is not a black-or-white issue. We can and should all agree that greater disclosure is better than the status quo as it exists today; and, yes, while we work to develop the best bill possible, we must also move forward expeditiously. Quick passage of this measure this year, before more and more money is spent undisclosed and in the dark of night, is vitally important.

I look forward to working with Congressman Castle, with you, Mr. Chairman, with Congressman Coyne, with Congressman Doggett, and all others who are interested in true and meaningful reform and not for political advantage.

I have been, Mr. Chairman, involved in lobbying reform, gift ban reform, line-item veto, and a number of other reform measures. They were only achieved at the point where we decided to act in a bipartisan fashion and came up with measures that would stand the scrutiny of the American public and the American media.

I look forward, Mr. Chairman, to working with all interested parties and I believe that the overwhelming sentiment in favor of the disclosure of the egregious and outrageous and obscene procedures that are going on in American politics today compels us to act quickly and expeditiously. And I say to my dear friend from Arizona, I want full disclosure too, but if you allow full disclosure of everything to be the enemy of disclosing the most egregious processes that are going on today, you will be doing a great disservice to the American people and the voters in the upcoming election.

I thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks very much, Senator.

Senator Lieberman.

**STATEMENT OF HON. JOSEPH I. LIEBERMAN, A UNITED STATES SENATOR FROM THE STATE OF CONNECTICUT**

Senator LIEBERMAN. Thanks, Mr. Chairman, Congressman Coyne, Members of the Committee. I appreciate very much the opportunity to be with you. I am particularly honored to be here with Congressmen Doggett and Castle and Senator McCain, who is our godfather. He might be called the commanding officer in the war to clean up our campaign finance laws. I am just reporting for duty here today, Mr. Chairman.

You have heard much today and will continue to hear, I am sure in greater depth, about the twisted and unjust logic of the 527 loophole—how groups benefit from the public subsidy of a tax exemption but then hide the source of their funding from the American public, or claim to be an organization influencing elections under one law and then turn around and deny exactly that under another.

What I want to focus on today briefly is the latest canard that has been launched against this campaign finance reform. And it is that it is wrong to target 527s and not other tax-exempt groups.

I believe deeply in the cleansing tide of disclosure, whether the contributing organization involved is a labor union, a business association, a for-profit company or a tax-exempt organization. In fact last year a majority of the Senate voiced its support for something quite close to full disclosure in the Snowe-Jeffords amendment to the McCain-Feingold bill.

Obviously if we can enact such comprehensive disclosure, we should. But we can't let this become, as Senator McCain has said, an all-or-nothing proposition. There are real differences between 527 organizations and other tax-exempts and these differences, I think, justify closing the 527 loophole even if we cannot enact broader reform.

Let me give two reasons why I believe that. First and foremost, section 527 organizations under the Tax Code that this Committee has jurisdiction over are different because they are the only tax-exempts that exist primarily to influence elections. That is not my characterization. That is the statutory definition. 527s are not lobbying organizations. They are not public-interest issue organizations. They are not labor or business associations. They are election organizations, plain and simple. You can't say the same about the AFL-CIO or the Chamber of Commerce or Handgun Control or the NRA, whose primary purpose is to advocate a policy position or represent specific constituencies. So I say respectfully to anyone who will argue that these 527 groups are just like other tax-exempts, take a look at the Tax Code; that is not true.

I also believe that while the fullest disclosure bill we can pass is clearly the best result, disclosure by 527 organizations is more needed than disclosure by other tax-exempts. When the AFL-CIO or the Chamber of Commerce runs an ad, we pretty much know who is behind it and where the money comes from—union member dues in the case of the labor organization and business member dues in the case of the Chamber. These groups provide the basic information the public needs to evaluate the motivation and credibility of the messenger.

The absolute opposite is the case with 527s. The public cannot know what hidden agenda may lie behind the message because so many 527s have unidentifiable names and are funded by sources that no one knows anything about. 527s are the most egregious abuse of our campaign laws that we have seen during this election cycle. We all seem to agree that the American people have an absolute right to know the identity of those spending money to influence their vote. So why let more time go by allowing these self-proclaimed election groups to operate in the shadows? Let us work to-

gether across party lines to turn the kleig lights of public disclosure on 527 organizations. Thanks, Mr. Chairman.

Chairman HOUGHTON. Thanks very much, Senator.  
[The prepared statement follows:]

**Statement of Hon. Joseph I. Lieberman, a United States Senator from the State of Connecticut**

Thank you Mr. Chairman and Members of the Committee for the opportunity to testify before you today on this issue so central to the fair working of our Democracy. As you may know, Senators Levin, Daschle, McCain, Feingold and I introduced legislation last month to close what has become known as the 527 loophole. Two weeks ago, the Senate adopted an amendment—thanks in large part to the legislative skill and persistence of Senators McCain and Feingold—that adds that legislation to the Defense Authorization bill.

Others on this panel will discuss in greater depth the twisted and unjust logic of the 527 loophole—how groups benefit from the public subsidy of a tax exemption but then hide the source of their funding from the American public—or claim to be an organization influencing elections under one law, while denying it under another.

What I want to focus on today is the latest canard launched against our proposal: that it's somehow wrong to target 527s and not other tax exempt groups. I believe deeply in the cleansing tide of disclosure, whether the contributing organization involved is a labor union, a business association, a for-profit company or a tax-exempt organization. Last year, the Senate adopted something close to full disclosure—the Snowe-Jeffords amendment—in the McCain-Feingold bill and, it was one of the grounds on which opponents of reform have attacked that bill. If we can enact such disclosure, we should. But this is not an all or nothing equation. There are real differences between 527 organizations and other tax exempts, and these differences justify closing the loophole, even if we can't enact broader reform.

First and foremost, Section 527 organizations are different because they are the *only* tax-exempts that exist primarily to influence elections. That's not my characterization. That's the statutory definition. 527s are not lobbying organizations. They are not public-interest issue organizations. They are not labor organizations or business organizations. They are election organizations, plain and simple. You can't say the same about the AFL-CIO or the Chamber of Commerce, or Handgun Control or the NRA, whose primary purpose is to advocate a policy position or to represent specific constituencies. So I say to anyone who claims these groups are just like other tax-exempts, "*read the tax code.*"

The fact is, disclosure by 527 organizations is more important than disclosure by other tax exempts. When the AFL or the Chamber of Commerce runs an ad, we know exactly who is behind it and where their money came from: union member dues in the case of the AFL, and business member dues in the case of the Chamber. These groups provide the basic information the public needs to evaluate the motivation of the messenger.

The absolute opposite is the case with 527s. The public can't know what hidden agenda may lie behind the message because so many 527s have unidentifiable names and are funded by sources no one knows anything about.

In the best of all possible worlds, all money supporting election-related activity would be disclosed. But we should not allow our inability to achieve that goal now to stand in the way of closing the most egregious abuse of our hard-won campaign laws that we have seen during this election cycle. We all agree the American people have an absolute right to know the identity of those trying to influence their vote. So why let another day go by allowing these self-proclaimed election groups to operate in the shadows. Let's work together, across party lines, to close the 527 loophole.

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Chairman HOUGHTON. Mr. Castle.

**STATEMENT OF HON. MICHAEL N. CASTLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF DELAWARE**

Mr. CASTLE. Chairman Houghton, Ranking Member Coyne, and distinguished Members of the Subcommittee, I am pleased to be here as well.

Current campaign laws are wholly unable to adequately regulate the torrent of political advertising by groups exploiting loopholes in both our election and tax laws. Huge sums of money are being spent to influence the election system, whether it is an individual spending tens of millions of dollars of his own money to win the election, or political parties spending millions in soft money to aid candidates.

While spending by individuals has been protected by Supreme court rulings and the problem of soft money continues because of a lack of will by Congress to address it, we now have a troubling new trend in campaign spending by groups operating under unique designations in our Tax Code such as section 527.

The average American is now bombarded by new advertising by groups with names such as Citizens for Better Medicare and Shape the Debate, who are spending large sums of money without disclosing their donors. Citizens for Better Medicare, a section 527 political organization not registered with the Federal Election Commission, has spent an estimated \$25 million to \$30 million on political ads. According to the Annenberg Public Policy Center at the University of Pennsylvania, the ad campaign is the costliest to date during the 1999/2000 campaign.

Whether or not we agree with the message of any ad campaign, I hope we could agree that voters have a right to know who is paying for any campaign-related ad. Our Constitution protects every American's right to be heard; yet today voters are faced with new-style political organizations, operating free from coverage by Federal election law, that are spending millions on campaign ads without having to disclose the true identities of their donors.

Disclosure is fundamentally fair to the public candidates and democracy in America. We must close these loopholes now. There is no reason to delay. The 2000 general election cycle is fast approaching and unknown political groups are expanding at a rapid pace that will be a dominant force in the 2000 election.

As this chart, which is over there in larger print shows, issue ad spending dramatically increases in the weeks before the election. We are on the road to doubling such expenditures in this election cycle. With this storm cloud of new campaign spending on the horizon, it is vitally important that we are here today to find a way to improve our laws to include full and equal disclosure for organizations that truly engage in electioneering activity. Congress must find common ground on this issue and resolve it in a bipartisan, bicameral manner as soon as possible.

The focus of debate and most legislation this year has only targeted the much-talked-about section 527 stealth organizations. These groups organize as a political organization under section 527 of the Tax Code which allows them to avoid disclosure of their donors. Reform must shed light on the 527 groups, but I want to emphasize that any legislation must fairly address campaign style ads by other groups as well. The 527-only approach might end some current abuses but only will provide a short-term solution. Inevitably, perhaps as early as this fall campaign, the same groups now operating under section 527 will regroup in some other form and continue to anonymously impact our elections.

Last week when a Federal election expert was asked where these groups would go if the 527 loophole was closed, he said, "That is for my paying customers." My bill, H.R. 4621, the Accountability and Disclosure Act of 2000, seeks to address this fundamental issue by requiring disclosure by organizations and all other groups that engage in sham issue ads.

As this chart shows, virtually all of these groups can now fund election-related ads without disclosure under Federal election law.

It is also important to know just how many of those groups exist. You are talking about hundreds of thousands of them, as you can see on the chart. These organizations do not disclose their donors because, like 527 organizations, they use the definitions in current law to argue that they do not have to adhere to Federal election rules because they do not advocate the victory or defeat of a candidate. If reform focuses only on the 527 designation, these groups may shift to another tax designation and continue to pay for campaign ads while avoiding the current inadequate Federal disclosure requirements. We will find ourselves confronting the same problems next year.

We need to make this legislation as effective and fair as possible with the understanding that there is not a perfect permanent solution. It has been said that legislation that goes beyond the 527 groups and includes activities by 501(c) groups would be a poison pill. Some argue that the right of individuals and groups to be heard makes disclosure unfair or impractical. I fully understand these concerns; but is it right to allow groups to blatantly influence elections by using loopholes in current law to run campaign advertising by calling it issue advocacy?

We can protect real issue advocacy and pass a fair bill to shed light on groups who are plainly seeking to influence elections. We can and should do this now. Legislation must be drafted that strikes a balance between the right to free speech and the right to a fair election. A well-balanced approach must carefully improve the current definitions of what constitutes political advertising and other efforts to influence a Federal election. My legislation was drafted in a way that would cover any group who spends \$10,000 in a year on election-related communications to disclose its donors who have contributed \$1,000.

Legislation on this subject navigates in precarious waters and a number of vital questions must be handled carefully:

First, what is a definition of a political ad? A political ad can be defined as any ad that seeks to influence an election by naming a Federal candidate in a defined period before an election. I am sure everyone can distinguish between a real issue ad and one that seeks to influence an election. I think we can fairly define them in law.

Second, should disclosure focus on periods right before elections? Whether it be 90 days before the election or 60 days before a primary, time periods could be established as to when disclosure is most needed. My legislation does not limit disclosure by time periods, but I would be willing to consider this approach.

Third, what other political activities should be covered? We should study improved disclosure of all election-related political activity that occurs through broadcast and cable TV, radio print poll-

ing, and Internet activities if it falls under a carefully defined definition of election-related activity.

Fourth, how should we treat groups that engage in issue advocacy? Many organizations engage in issue advocacy but election-related issue advocacy is another matter. All groups who engage in election-related communications should be treated fairly. We can protect groups and the rank-and-file members who are not engaging in political advertising.

Fifth, when should new disclosure standards go into effect? It should go into effect immediately, to help make the 2000 elections more fair and open.

In conclusion, we can protect the rights of the rank-and-file members of business, labor, and nonprofit groups to express their views on all issues while also improving disclosure of election-related advertising and other efforts intended to influence an election. I thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks very much, Mr. Castle.

[The prepared statement follows:]

**Statement of Hon. Michael N. Castle, a Representative in Congress from the State of Delaware**

Chairman Houghton, Ranking Member Coyne, Members of the Subcommittee, I want to thank you for giving me this opportunity to testify on the importance of improving disclosure of political advertisements by tax exempt organizations. Current campaign laws are wholly unable to adequately regulate the torrent of political advertising by groups exploiting loopholes in both our election and tax laws. Huge sums of money are being spent to influence the election system regardless of whether it is an individual spending tens of millions of his own money to win an election, or political parties spending millions in soft money to aid candidates.

While spending by individuals has been protected by Supreme Court rulings and the problem of soft money continues because of a lack of will by Congress to address it, we now have a troubling new trend in campaign spending by groups operating under unique designations in our tax code such as Section 527. The average American is now bombarded by new advertising by groups with names such as "Citizens for Better Medicare" and "Shape the Debate," who are spending large sums of money without disclosing their donors.

"Citizens for Better Medicare," a Section "527" political organization not registered with the Federal Election Commission, has spent an estimated \$25 million to \$30 million on political ads. According to the Annenberg Public Policy Center at the University of Pennsylvania, the ad campaign is the costliest to date during the 1999-2000 campaign. Whether or not we agree with the message of any one ad campaign, I hope we could agree that voters have a right to know who is paying for any campaign-related ad. The Shays-Meehan and the McCain-Feingold legislation would truly reform the broken campaign finance system by addressing the problem of soft money donations and issue ads in a comprehensive manner. Unfortunately, Congress has not been able to pass this important legislation.

However, we must improve disclosure of campaign spending as an important first step toward fixing the system. Our Constitution protects every American's right to be heard. Yet today, voters are faced with new-style political organizations, operating free from coverage by federal election law, that are spending millions on campaign ads without having to disclose the true identities of their donors. Disclosure is fundamentally fair to the public, candidates and democracy in America.

We must close these loopholes now. There is no reason to delay. The 2000 general election cycle is fast approaching, and unknown political groups are expanding at a rapid pace and will be a dominant force in the 2000 election. As Chart #1 (attached) shows, issue ad spending dramatically increases in the weeks before an election.

We are on the road to doubling such expenditures this election cycle. With this storm cloud of new campaign spending on the horizon, it is vitally important that we are here today to find a way to improve our laws to include full and equal disclosure for organizations that truly engage in electioneering activity.

This issue affects each and every person in this room, regardless of party, and more importantly it affects each and every American's right to vote in a fair elec-

tion. Congress must find common ground on this issue and resolve it in a bipartisan, bicameral manner as soon as possible. Between now and the July 4th recess we have a window of opportunity that has been opened by the hard work of members in both parties and chambers. We must act on it now.

The focus of debate and most legislation this year has only targeted the much-talked-about Section 527 “stealth organizations.” These groups organize as a political organization under Section 527 of the tax code which allows them to avoid disclosure of their donors.

Reform must shed light on the 527 groups, but I want to emphasize that any legislation must fairly address campaign-style ads by *other groups* as well. The 527-only approach might end some current abuses, but it would only provide a short-term solution.

Inevitably, perhaps as early as the fall campaign, the same groups now operating under Section 527 will regroup in some other form and continue to anonymously impact our elections. Last week, when a Federal Election expert was asked where these groups would go if the 527 loophole was closed, he said, “that’s for my paying customers.” My bill, H.R. 4621, “The Accountability and Disclosure Act of 2000,” seeks to address this fundamental issue by requiring disclosure by 527 organizations *and* all other groups that engage in “sham issue ads.” These other entities are also designated under Title 26 of the Internal Revenue Code. Some of these groups include:

- 501(c)(4)(social welfare and lobby groups),
- 501(c)(5)(labor groups) and
- 501(c)(6) (trade associations, business leagues, and Chambers of commerce)

As this chart shows (Chart #2, attached), virtually all of these groups can now fund election-related ads without disclosure under federal election law. It is also important to note just how many of these groups do exist. These organizations do not disclose their donors because like 527 organizations they use the definitions in current law to argue that they do not have to adhere to Federal Election rules because *they do not advocate the victory or defeat of a candidate.*

If reform focuses only on the 527 designation, these groups may shift to another tax designation and continue to pay for campaign ads while avoiding the current inadequate federal disclosure requirements. We will find ourselves confronting the same problems next year. We need to make this legislation as effective and fair as possible, with the understanding that there is not a perfect, permanent solution.

It has been said that legislation that goes beyond the 527 groups and includes activities by 501(c) groups would be a poison pill. Some argue that the right of individuals and groups to be heard makes disclosure unfair or impractical. I fully understand these concerns, but is it right to allow groups to blatantly influence elections by using loopholes in current law to run campaign advertising by call it issue advocacy? We can protect real issue advocacy and pass a fair bill to shed light on groups who are plainly seeking to influence elections. We can and should do this now.

Legislation must be drafted that strikes a balance between the right to free speech and the right to a fair election. A well-balanced approach must carefully improve the current definitions of what constitutes political advertising and other efforts to influence a federal election. My legislation, The AD Act, was drafted in a way that would cover any group which spends \$10,000 dollars in a year on election related communications to disclose its donors, who have contributed \$1000.

Legislation on this subject navigates in precarious waters and a number of vital questions must be handled carefully. *First*, what is the definition of a political ad? A political ad could be defined as any ad that seeks to influence an election by naming a federal candidate in a defined period before an election. I am sure everyone can distinguish between a real issue ad and one that seeks to influence an election. I think we can fairly define them in law.

*Second*, should disclosure focus on periods right before elections? Whether it be 90 days before the election or 60 days before a primary, time periods could be established as to when disclosure is most needed. My legislation does not limit disclosure by time periods, but I would be willing to consider this approach.

*Third*, what other political activities should be covered? We should study improved disclosure of all election-related political activity that occurs through broadcast and cable TV, radio, print, polling and Internet activities if it falls under a carefully defined definition of election-related activity.

*Fourth*, how should we treat groups that engage in issue advocacy? Many organizations engage in issue advocacy, but election related issue advocacy is another matter. All groups, who engage in election related communications, should be treated fairly. We can protect groups and their rank and file members who are not engaging in political advertising.

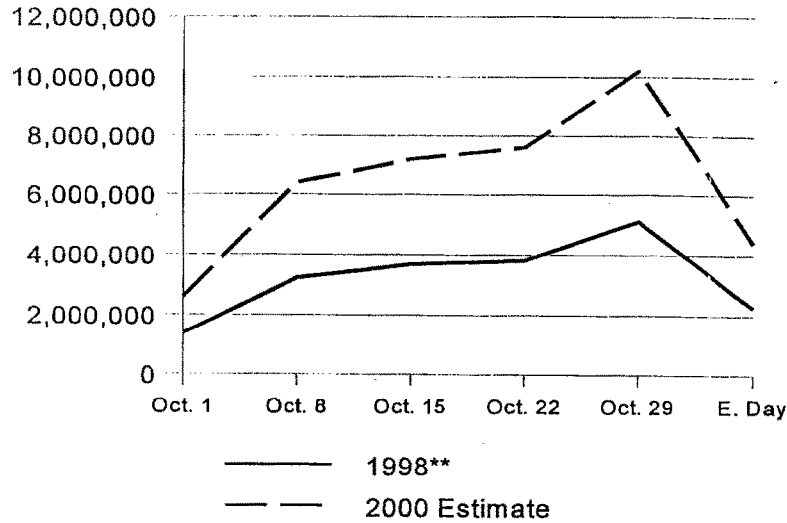
*Fifth*, when should new disclosure standards go into effect? It should go into effect immediately to help make the 2000 elections more fair and open.

I strongly favor the principles of equal treatment I outlined in my legislation, The AD Act. However, I do understand that too broad of an approach could threaten legislation in the short time we have to act. Our desire to improve disclosure in the election process comes right up against the important pillar of freedom of speech. We can balance these important principles.

We must require disclosure by 527 organizations *and* provide meaningful coverage of activities by other groups that are clearly election-related and political in nature.

We can protect the rights of the rank and file members of business, labor, and nonprofit groups to express their views on all issues, while also improving disclosure of election-related advertising and other efforts intended to influence an election. Thank you Chairman Houghton for your commitment to this important issue. I look forward to your Subcommittee's consideration of bipartisan, fair campaign finance disclosure legislation.

## TV Issue Ad Spending



\*\*Source: Brennan Center for Justice at NYU



**IN ADDITION TO SECTION 527 GROUPS, THE FOLLOWING ORGANIZATIONS  
HAVE THE POTENTIAL TO PARTICIPATE IN ELECTION-RELATED  
ADVERTISING AND ARE NOT COVERED UNDER ELECTION LAW\***

• 501(c)(3) - CHARITABLE ORGANIZATIONS	776,577 NATIONWIDE
• 501(c)(4) - SOCIAL WELFARE/LOBBY GROUPS	138,998 NATIONWIDE
• 501(c)(5) - LABOR/AGRICULTURAL ORGANIZATIONS	63,708 NATIONWIDE
• 501(c)(6) - BUSINESS LEAGUES/CHAMBERS OF COMMERCE	81,489 NATIONWIDE

\* SOURCE: JOINT COMMITTEE ON TAXATION

Chairman HOUGHTON. I know we indicated to your staffs that there would be no questions, but it is so tempting that you gentlemen are here. Maybe you wouldn't mind if we asked maybe one or two questions of you. I would like to ask Mr. Coyne if he would like to ask.

Mr. COYNE. Thank you, Mr. Chairman. Welcome, Senator McCain, and the other panelists. Thank you for your testimony. Senator McCain, as I understand part of your proposal, you support a clear and objective standard for each of the three following entities: Requiring disclosure of expenditures and contributors; number two, by organizations that spend \$10,000 or more a year on express advocacy mass media election hearing ads; and three, several months before a general election or a primary. I just wonder why is—that is essentially Senator Snowe's proposal, S. 79. Why is that preferable to a more expanded inclusion?

Senator MCCAIN. Congressman Coyne, in a perfect world I would like to see and would hope that we could adopt the broadest possible coverage of organizations or individuals who are involved in any political campaign. I am worried about NAACP versus Alabama and the Court's interpretation there, and I believe that in a perfect world, all of those things that you just described should be enacted into law.

But I also worry, in all due respect to some of my friends, that in our efforts to make it so encompassing, we then fail to gain sufficient support for passage of legislation. As my friend Senator Lieberman pointed out, 527s are different. They are different. There is never any time when those people who are involved in that are disclosed. In the case of Chamber of Commerce, the dues payers are disclosed, and so forth, and so forth.

But, finally, I really believe that Senator Snowe's proposal does pass constitutional muster; and that is, within 30 days of a primary or within 60 days of a general election, that the use of a

name or likenesses of a candidate then should be fully disclosed. I hope that the Committee would consider that provision.

Mr. COYNE. Senator Lieberman, I was interested in your observation that 527s, as I recall what you pointed out, are just essentially political organizations. Could you expand on that?

Senator LIEBERMAN. Thanks, Congressman Coyne. That is, in fact, what that section of the Code is all about. There are so many other problems in our campaign finance laws, such as soft money itself, that started out with good intentions and got misused. In this case, 527s were created to make clear that a normal full-time organization which has the sole intention of affecting elections shouldn't have to pay taxes. And then, through misuse of some IRS rulings essentially, a whole group of political groups, interest groups on all sides of the ideological spectrum, began to get away with claiming they deserve the tax protection but didn't need to file under the Federal Elections Campaign Act because they weren't saying the magic words in their advertising: Vote against this guy, or vote for this woman.

Mr. COYNE. Thank you very much.

Senator MCCAIN. Congressman Coyne, may I make one additional comment? That is why severability is a very important part of this legislation, because we are—if it is expanded, because it is not clear exactly because of—and you will hear differing opinions from panelists who are following us as to exactly where you are constitutionally and where you aren't. I thank you for allowing me to add that.

Chairman HOUGHTON. Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman. Congressman Castle, I regret the fact that your staff took away the second chart. My eyes are getting a little bad. Maybe I need my glasses. Could you for the record just read the different groups on the second chart that you have there in your possession?

Mr. CASTLE. I would be glad to. It doesn't actually name the particular organizations, but it goes through the different 501(c) classifications, a few of them. 501(c)(3)'s are charitable organizations. There are 776,577 of them. 501(c)(4), social welfare lobby groups, there are 138,998 of them. This is nationwide. 501(c)(5) are labor—agriculture organizations, 63,708 of them. 501(c)(6) are business leagues, chambers of commerce, there are 81,489 of these nationwide.

Obviously my concern is—I don't disagree with anything that was said here. I am for whatever we can get done. If we can only get done 527s, I am going to try to lead the fight for that. But if we can be more comprehensive, if after you hear experts today, we can go and reach out and embrace other groups in terms of limitation on advertising or at least disclosure for advertising, I would like to see that happen. Obviously you have hundreds of thousands of organizations and, as the experts will tell you, you can shift pretty—I agree, 527s are just political organizations, but you can shift pretty quickly from a 527 to another organization. Even though there may be greater IRS requirements, the ability to advertise anonymously pretty much continues. Maybe we can't do it, but maybe we can. I don't want to give up in the next week before we bring this to the floor without at least looking at that.

Mr. HAYWORTH. For a more complete disclosure, you endorse the notion of a more complete bill that deals with these other organizations where you have different groups will scurry to something else.

Mr. CASTLE. That is correct. I think it is vital to understand that it will never, ever work unless it is entirely fair and you include every single organization. The limitations have to be on what triggers the disclosure. Is it truly political campaign advertising? In my bill they are in excess of \$10,000. Then you have to show those who have contributed a thousand dollars to that political campaign advertising. Can we write the definitions to do this? We tried to in a limited group in my office with the research we could do. You may reach a conclusion we can't. I hope that we can. I think it is worth at least looking at.

Mr. HAYWORTH. Senator McCain, thank you again, my friend. We are very good friends although we may have a bit of a disagreement. I don't believe we want to make the perfect the enemy of the good, but part of the challenge I have even in a bipartisan setting is limiting the action in some way that could give one party or another an advantage, and I would just like to hear from you again why.

Senator MCCAIN. I would be curious how you think that just—I share Congressman Castle and everyone's desire to expand it as much as possible. But there is no way that I know of that 527s favor one party or another, one group or another. It is an egregious and obscene distortion of everything the American people believe in, and it should be eliminated. It is like saying we have got certain evils in our society—rape, murder, and robbery—and we shouldn't get rid of one of the three if we can, for the sake of saying, well, we can't get rid of all three. It is ludicrous.

So if you can make the case to me that somehow 527s favor Republicans or Democrats, then I would be more than willing to say, well, you know, we shouldn't get rid of them. But there is no evidence to that. In fact, it will be exploited, as is the case with every other evil in American campaign financing, it will be exploited by both sides to a dramatic degree.

With all due respect for those who say this doesn't go far enough so therefore I can't support the elimination of 527, then the motivation must be suspect.

Mr. HAYWORTH. I thank you, Senator McCain. I do believe that we can have a more complete bill. I look forward to working with Congressman Castle. We have an honest disagreement. I guess the thing that concerns me as a newcomer to Washington is how often we allow certain folks to say this is a poison pill.

For example, earlier attempts at campaign finance reform that you have made, where labor unions were not required to truly protect paychecks for their membership that didn't want money going into political campaigns. My concern is that somehow we define bipartisan as the will of the majority, bending to the whims of the minority. I think if we can have true bipartisanship that deals with all of these issues, we would be better off. I thank all you gentlemen for coming.

Senator MCCAIN. In all due respect, again my proposal is that if you have paycheck protection for the unions, you should also then

require disclosure—I mean permission of stockholders for corporations that engage in political activities. I think that is perfectly fair. I have always supported that.

Again, in all due respect, to say that somehow you would oppose eliminating this most egregious and latest outrageous aspect of the abuse of campaign financing in America because it doesn't encompass others—and again I don't get that logic. That is like accepting one evil in American society because we can't get rid of other evils.

Again, we have a fundamental disagreement. I hope we can make progress. I have been involved in reform issues for many, many years and I know with some of them you have to work incrementally. Again, reiterating my profound and deep commitment to supporting the ideas that Congressman Castle has that we expand it as far as we can; but if we can't, then I say at least get rid of the 527s. I thank you.

Chairman HOUGHTON. Thanks very much. Mr. Lewis.

Mr. LEWIS of Georgia. Thank you, Mr. Chairman. Mr. Doggett, could you tell us whether there is a directory, some book that you can go and pick up someplace, an encyclopedia of these 527 organizations? If the average American wanted to get a list of these organizations, these groups, is there any place that you can find that list, that directory?

Mr. DOGGETT. There is not. We know them only by their deeds, and sometimes by inquisitive reporters who are able to explore what these Committees are doing. But I tried to find out some indication in preparing the legislation, even from the Internal Revenue Service, and I don't think they know how many 527s there are out there.

Mr. LEWIS of Georgia. You are telling Members of the Committee that you don't have any idea, but you have some idea, how many?

Mr. DOGGETT. I don't have an idea of how many there are.

Mr. LEWIS of Georgia. What about other members of the panel? Do you have any idea how many of these organizations exist?

Senator MCCAIN. Congressman Lewis, I think as you are speaking, several more are being formed right now.

Senator LIEBERMAN. Congressman Lewis, that is just the point. They are so far into the shadows, into the dark, that we have no idea until we see them come out under a cloak to advertise and try to influence an election, but even then we have no way of knowing exactly who they are and who is supporting them financially.

Mr. LEWIS of Georgia. Thank you, Mr. Chairman. I thank the members of the panel.

Chairman HOUGHTON. Thanks very much, Mr. Lewis. Mr. Watkins.

Mr. WATKINS. Mr. Chairman, I got here a little late. I have been very interested in the discussion of all this. Like many of my colleagues, I want the cleanest situation going. So where the money comes from, I don't have any problem with it being disclosed. I always try to disclose.

I think my good friend from Arizona, Mr. Hayworth, has got some points. I understand Senator McCain said well, we will go after one section of this, if we can't get it all. But sometimes you meet people out there a little more partial, can have a greater influence on one party than the other.

I just think that all parties should be created equal, and I think that all of the relationships should be gotten to, not just part of them. So I don't have any—I am trying to work rationally through this. Ever since I have been in public office, I have always revealed every dollar that I have taken, so it is something I have always done. And I know there is a lot of outside money that seems to be having a great influence in today's society. All I know is you end up having to spend 6, 7 hours a day, raising dollars. That is a terrible way to spend time, but you have to do it to fight off the battles.

I think coming here, I spent less than \$100,000, or 200,000 at the most when I first came, and now it is up to 1.2 million. And that is not the fault of just the contributors, it is the fault of all these expenses. So I appreciate each of you coming and trying to elaborate on this, and I am making some notes along the way and trying to come down with what the right decision might be.

Mr. Chairman, that is all I have. I am sorry I was late for getting here for the discussion today.

Senator MCCAIN. Could I respond very briefly? A couple of weeks ago there was a fund raiser held, and the head of a union local walked up and set a record—I believe it was a record—and handed a Democratic—I believe it was the Congressional Campaign Committee—a \$1 million check. That is the last time you will ever see that. The next time that union leader, along with whoever the businessman is, is going to form up a 527. Why get the publicity associated with handing somebody a \$1 million check? Why not set up a 527? Then no one will ever know.

My response to you and Congressman Hayworth is there is no evidence that 527s will favor one side or another. It will only favor those with money. And to somehow assume that this favors one side or the other when it is just an egregious, egregious insult, I mean, I promise not to go through my diatribe about soft money, but the 527s are really something that if you ask any average American citizen whether they believed it is possible to do that today, they would be incredulous. I know they are incredulous because I ask them. So I thank you, Congressman Watkins.

Mr. WATKINS. Appreciate your comment.

Senator LIEBERMAN. Mr. Chairman, if I may add just a word about Mr. Watkins' concern. The evidence that we have is incomplete, but we can see your concern about the possible partisan impact of focusing in on 527s. There is certainly nothing in the tax law that would suggest that. We see organizations, both on the left and right, who are beginning to use it. It happens that right now, some of the more prominent elected officials who seem to have 527 organizations associated with them are Republicans. But I will tell you, just as John said a short while ago, if we don't close this loophole, there will be as many or more Democratic elected officials who will have 527s before this is over.

So, unfortunately, this is an equal opportunity abuse, and if we don't close it, it is going to be abused by everybody.

Chairman HOUGHTON. Mr. Neal?

Mr. NEAL. Thank you. Senator McCain, are you troubled by the fact that you are more popular with some Democrats in Massachusetts than Republicans in Arizona?

Senator MCCAIN. Actually, I am very flattered and honored to have the support of Republicans and Democrats alike. Libertarians and vegetarians as well. I thank you. I had a wonderful—I have had a wonderful time in your State, and it is a very lovely State and some wonderful people there.

Mr. NEAL. Jeez, it is nice to hear a Republican say that. The whole idea, the singular idea that dates all the way back to campaign finance reform, was the notion of disclosure. It runs through every piece of legislation. It is noted in *Buckley v. Vaele* where the Court holds the position that disclosure is the great disinfectant. And yet we find ourselves now with an element trying to thwart the whole notion of disclosure and allowing the public to make up their own minds.

Let me ask you a specific question, Mr. Doggett. What type of information campaigns are you concerned about that involve 527 organizations. What are they doing?

Mr. DOGGETT. I think these are the kind of organizations that tend to fill our airwaves with hate and our mailboxes with junk mail that distort things, and I share completely the views that have been expressed by my colleagues here today that this needs to be bipartisan, that it is not designed to favor one party over another.

I support the suggestion that Senators McCain and Lieberman have made, and I believe Mr. Castle has joined a letter on it that we look at this Snowe provision that the Senate adopted in the past as one way of doing it.

But I will just give you an example of the most recent one that I have seen which concerns our colleague, Congressman Mike Forbes, and this is a mailer that I suppose went to Democratic households. It says Congressman Mike Forbes stood with Newt Gingrich 100 percent on the Contract With America, and it is very interactive. It allows the recipient to write back on which of Mike Forbes' conservative votes make you the proudest to say whether you agree—your yes or no on whether his right to support Newt Gingrich in the Contract With America was good, and his support of the Christian Coalition. The only identifying mark anywhere on here is RMIC, and unless you know that RMIC in Arlington, Virginia is Tom DeLay's Republican Majority Issues Committee, you wouldn't know that it is he who is complaining of support for Newt Gingrich.

I would not in any way limit the free speech rights of Mr. DeLay or anyone else to put out this kind of literature. I only seek to have them disclose who paid for it, how much they spent on it, and who they are. And I think that is just part of fair play, and I think this may be done this month. New York seems to be kind of the testing grounds.

So, Senator McCain, for all these great 527s this year, I think we had some Texans up there doing it, too. It is going to happen in Texas or Washington or Massachusetts, and one time it may be a Republican ally and another time it may be a Democratic ally. This is our best chance, day after tomorrow in this Committee, less than 48 hours away, and a week away from action on the floor of the House, to fine-tune this legislation, and to pass something that will do something about this and all the hate ads before November.

Senator MCCAIN. Congressman Neal, could I make one additional comment? The reason why I quoted the Wall Street Journal, the Wall Street Journal has been one of the strongest opponents of McCain-Feingold-Shays-Meehan, but even the Wall Street Journal has said full disclosure in Shrink versus Missouri, the Supreme Court decision upholding the \$1,000—constitutionality of the \$1,000 contribution limit—even the dissenting Justices Kennedy and Thomas both said that you have got to have disclosure as the answer, but remember, only as related to election activity.

That is why I caution my friends as to how far the reach of this full disclosure is, because constitutionally it can only be as related to election activity. I thank you.

Mr. CASTLE. May I respond a little bit further, too? I don't disagree with anything anybody has said. I am one of those who, if we can't get done the more expanded views that I had that we should include some of the 501(c) groups, I will go back to the 527s in a minute. But I understand with Snowe-Jeffords, for example, it does not include printed matter, as an example.

And I am very concerned about whatever you are going to do in this Committee in the next 2 or 3 days. I want to see all this be as comprehensive as possible, and maybe that is a wish list that is too large and it needs to be pared down, but I think we need to look at the specific kind of political matter that is being dealt with. We need to look at the particular groups that are being dealt with. We need to look at dates. We need to look at a whole variety of issues, a lot of which have been discussed here today. And fortunately you have some wonderful panelists who are probably getting a little tired of waiting, I might add, who are following us, who can add to all this as well. I hope when you make your decision, you make it as comprehensive as you can but within the bounds of everything we have heard here, particularly from the other three witnesses, that which is enforceable under our Constitution today.

Mr. NEAL. Superb testimony. If I could close on this with Senator Lieberman perhaps. You said, correctly summing things up, that disclosure would allow the voter to properly evaluate the message.

Senator LIEBERMAN. Yes. In other words, it would tell us who is behind the message, answering our basic right to know. If your mind is being propagandized and your vote attempted to be influenced, it seems fair to know who is paying for it.

Mr. NEAL. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks very much. Mr. McDermott?

All right. Well, gentlemen, thank you so much. I really appreciate it, and we will try to follow your advice.

On the second panel we have Lindy Paull, chief of staff, Joint Committee on Taxation, and Joseph Mikrut, tax legislative counsel, Department of Treasury. Thank you very much for joining us today.

Mr. Mikrut, would you like to begin your testimony.

**STATEMENT OF JOSEPH M. MIKRUT, TAX LEGISLATIVE  
COUNSEL, U.S. DEPARTMENT OF THE TREASURY**

Mr. MIKRUT. Thank you, Mr. Chairman and Mr. Coyne and Members of the Subcommittee and Full Committee.

I appreciate the opportunity to discuss the issue of disclosure of political activities of tax exempt organizations. This Subcommittee has, over the last several years, built an impressive record of examining the Federal tax rules applicable to tax exempt organizations. At the outset, I would like to emphasize that the Administration strongly supports efforts to require greater disclosure of political campaign contributions and expenditures as part of its ongoing efforts to achieve comprehensive campaign finance reform. Some of the disclosure and reform proposals raise issues outside of the Internal Revenue Code, such as the Federal election law issues and constitutionality issues, which are generally beyond the expertise of the Treasury Department.

However, recent developments involving so-called 527 organizations show the interplay between Federal election law and tax law rules. I will focus my remarks today on issues that arise in the Internal Revenue Code principally in three areas. First, the tax treatment of the organizations and their contributors; second, the activities that these organizations can or cannot engage in; and third, the disclosure rules applicable to the organizations and their contributors.

I would like to focus on three types of entities. First charities, as defined in 501(c)(3) of the Code, tax exempt nonprofits such as described in 501(c)(4), (c)(5) and (c)(6), and political organizations described in section 527.

Organizations described as 501(c)(3) are commonly referred to as charities. Compared to other tax exempt organizations, charities are eligible for the most tax-preferred treatment. They are generally exempt from tax at the entity level, can receive tax deductible contributions and have access to tax-exempt financing.

At the same time, charities are subject to the most stringent rules with respect to their advocacy activities. Charities are prohibited from intervening in any political campaign on behalf of, or in opposition to any candidate and may not engage in more than an insubstantial amount of lobbying in an attempt to influence legislation. 501(c)(3) status is violated when a charity intervenes in a political campaign on or behalf, or in opposition to, any candidate. The determination of whether this prohibited activity occurs generally is based on a facts-and-circumstances test.

Because a charity may not engage in political campaign intervention, there generally is no disclosure regime provided by the Internal Revenue Code for prohibited political campaign activities of charities. When a charity improperly engages in political intervention and loses its tax-exempt status, the IRS will inform the public of this loss of exemption. Moreover, penalty excise taxes may be imposed by the IRS under section 4955 as an alternative to revocation. The imposition of this penalty is disclosed to the public.

As a general rule, 501(c)(3) provides that no more than an insubstantial amount of activities of a charity may be attempting to influence legislation or lobbying. Although there are three sets of overlapping rules governing lobbying, the determination of whether lobbying exists definitionally is the direct contact of members of a legislative body or their staff to support or oppose legislation (so-called direct lobbying), or the influencing or urging of the public to contact legislative bodies (so-called grassroots lobbying).



Charities must disclose their lobbying activities to the IRS and the general public by reporting of their annual information return form 990, the amount and extent of their lobbying expenditures for the taxable year. If a charity improperly engages in substantial lobbying, their tax status is jeopardized and potential penalties may be applied. These also are disclosed. The annual information return form 990 required to be filed by a charity is made public and contains a variety of information about the charity's operations for the taxable years.

When filing this return with the IRS, charities also must attach a list that identifies the names and addresses of all substantial contributors, generally those who contribute more than \$5,000 for the year. This list is not publicly available. Any organization that fails to complete an accurate form 990 or fails to make it publicly available is subject to a penalty.

Nonprofit organizations, include and are described in 501(c)(4) as social welfare organizations; (c)(5), labor and agriculture organizations; (c)(6), business leagues; and (c)(7), social clubs. These nonprofits generally are exempt from tax on dues and contributions, related function income and investment income. Contributions to noncharities generally are not deductible to the donor for Federal income, estate or gift tax purposes. However, in some instances, contributions or dues may be deductible by the payor as a trade or business expense. Noncharities generally are not restricted by the Internal Revenue Code from engaging in political campaign activities. However, political campaign activities cannot be the primary activity of the entity.

To the extent that a noncharity engages in any political campaign activities, the organization is subject to tax on the lesser of its investment income or the amount expended on political campaign activities. The objective of this rule is to prevent organizations from using tax-free investment income to fund political campaign intervention. Noncharities must indicate on their form 990 the amount of expenditures for political campaign intervention and must indicate whether they filed a form 1120 POL. This is a form on which they report their investment income and pay tax.

Form 1120 POL does not list the contributors to the organization or the recipients of the disbursements and the return is not made public.

Noncharities are not subject to any specific tax provision that restricts their lobbying activities. Indeed, lobbying may be the primary activity of some tax exempt organizations. In general, the only theoretical limit is that the lobbying activities must somehow further the entities' nonprofit purposes. Noncharities generally have the same form 990 filing requirements as charities.

Finally, section 527 governs the tax treatment of political organizations, meaning a party, Committee, association fund, or other organization to organize and operate primarily for the purpose of directly or indirectly accepting contributions or making exceptions for the purpose of the function of influencing, or attempting to influence the selection, nomination, election or appointment of any individual to any Federal, State or local public office or political organization, or the election of the president or vice president electors,

whether or not such individual or electors are selected, nominated, elected or appointed.

When enacted, section 527 clarified the tax treatment of political organizations, providing that contributions received by the entity or the fund are not subject to tax while investment income and any income from events that are not political in nature are subject to tax at the highest corporate rate.

In addition, contributions to section 527 political organizations are exempt from Federal gift tax. In determining whether a particular activity constitutes the organization's exempt function for purposes of section 527, the IRS examines all relevant facts and circumstances to determine if there is a sufficient nexus between the activity and the election of a public official.

The scope of finance campaign-related activities under section 527 is broader than the definition of express advocacy under the Federal Election Campaign Act. Thus section 527 applies to express advocacy in the FEC sense as well as issue advocacy not subject potentially to FEC regulation. Issue advocacy includes the conduct or funding of biased voter education efforts, targeted voter registration efforts, or grassroots lobbying intended to influence an election, although the organization does not expressly advocate the election or opposition of any particular candidate.

The general issues presented by section 527, and 501(c)(3), and (4), (5) and (6) organizations are the following: It appears that the general tax rules applicable to 501(c)(3), (4), (5) and (6) and 527 entities is appropriate. Contributions to 527 organizations are not deductible Federal income tax purposes, and even in cases where contributions to a section 501(c)(3) or (4) organization may be deductible as a business expense or charitable contribution, no deduction is allowed for the portion applicable to political activities. Essentially what we are discussing today are the definitional and disclosure rules applicable to these entities.

Mr. Chairman, in summary, what I would like to point out is that the Administration supports enhanced disclosure by political organizations as part of its ongoing efforts to achieve comprehensive campaign tax reform. Just as the current Tax Code rules do not distinguish between express advocacy and issue advocacy, so too should the disclosure requirements governing political organizations, either under the Internal Revenue Code or the Federal election laws, not depend on formalistic distinctions between cases which are obviously designed to influence elections.

The important public interest to be served by disclosure is equally applicable to all political organizations, regardless of whether they attempt to influence Federal elections through issue or express advocacy. As several recently introduced bills demonstrate, there are alternative approaches for achieving consistency in the disclosure obligations. The Treasury looks forward to working with you, Mr. Chairman, and Mr. Coyne, and Members of the Subcommittee to craft legislation to achieve this end.

Chairman HOUGHTON. Thank you, Mr. Mikrut.

[The prepared statement follows:]

**Statement of Joseph Mikrut, Tax Legislative Counsel, U.S. Department of the Treasury**

Mr. Chairman, Mr. Coyne, and distinguished Members of the Subcommittee:

I appreciate the opportunity to discuss with you today the issue of disclosure of political activities of tax-exempt organizations. At the outset, I would like to emphasize that the Administration strongly supports efforts to require greater disclosure of political campaign contributions and expenditures as part of its on-going efforts to achieve comprehensive campaign finance reform. Some of the disclosure proposals raise issues outside the tax code—such as Federal election laws issues—which are generally beyond the expertise of the Treasury Department. However, recent developments involving so-called “section 527” organizations show the interplay between the Federal election laws and tax code rules. I will focus my remarks today on issues that arise under the Internal Revenue Code.

#### INTERNAL REVENUE CODE RULES

##### *In general*

Twenty-seven different types of tax-exempt organizations are described in section 501(c) of the Internal Revenue Code.<sup>1</sup> These organizations—which cover a wide range of nonprofit entities, including charities, social welfare organizations, labor unions, business leagues, and social clubs—generally are exempt from Federal income tax (other than with respect to certain unrelated business income). In addition, section 527 provides a limited tax-exempt status to certain “political organizations,” meaning parties, committees, funds, and other organizations that are organized and operated primarily for the purpose of accepting contributions or making expenditures to influence the selection of an individual to public office. Section 527 entities are exempt from tax on political contributions they receive (and certain other political fundraising receipts), but are subject to tax on their investment income.

The different tax-exempt organizations are subject to different rules under the Internal Revenue Code with respect to their “political” (in the broad sense of the term) activities. In particular, the tax code differentiates “lobbying” with respect to legislation from “political campaign intervention” (sometimes referred to as “electioneering”), even though both types of advocacy activities are commonly thought of as being “political.” In discussing the rules governing participation by tax-exempt entities in political activities and disclosure of such activities, it is necessary to keep in mind the different types of tax-exempt entities and to distinguish lobbying from political campaign intervention.

#### CHARITIES

##### *Exempt Status*

Organizations described in section 501(c)(3) are commonly referred to as “charities.”<sup>2</sup> Compared to other tax-exempt organizations, charities are eligible for the most preferred tax-exempt status under the Code. That is, not only are charities generally exempt from tax at the entity level, they also have access to tax-exempt financing and are eligible to receive contributions that are deductible for Federal income, estate, and gift tax purposes.<sup>3</sup> At the same time, charities are subject to the most stringent rules with respect to their advocacy activities. Section 501(c)(3) expressly provides that charities are prohibited from intervening in any political campaign on behalf of (or in opposition to) any candidate for public office; and charities may not engage in more than “insubstantial” lobbying in an attempt to influence legislation.

##### *Political intervention by charities*

Although charities are absolutely barred from intervening in a political campaign on a partisan basis, charities may engage in some election-related activities—such as voter registration efforts or sponsoring a debate—provided that the activities are not biased towards a particular candidate.<sup>4</sup> Section 501(c)(3) is violated when a charity intervenes in a political campaign “on behalf of (or in opposition to) any candidate.” However, in cases where the charity does not directly provide financial sup-

<sup>1</sup> Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended.

<sup>2</sup> “Charities” include public charities (such as churches, schools, hospitals, and organizations that receive their support from a broad range of public sources) and private foundations (which generally are closely controlled and, thus, are subject to special rules under the Code).

<sup>3</sup> However, contributions to a charity are not deductible if earmarked for lobbying activities. See Treas. Reg. Sec. 1.170A-1(j)(6). In addition, no deduction is allowed for out-of-pocket expenditures made on behalf of a charity (other than a church) if the expenditure is made for lobbying purposes. See section 170(f)(6).

<sup>4</sup> See, e.g., Rev. Rul. 80-282, 1980-2 C.B. 178. Special rules apply to private foundations under section 4945(f).

port to a candidate, or explicitly endorse or oppose a candidate, the determination of whether prohibited political campaign intervention has implicitly occurred is made by the IRS on the basis of all facts and circumstances. In this regard, the IRS does not use the Federal election law “express advocacy” standard (which is discussed below).<sup>5</sup>

Because a tax-exempt charity may not engage in political campaign intervention consistent with its section 501(c)(3) status, there generally is no disclosure regime provided by the Internal Revenue Code for prohibited political campaign activities of charities. If a charity improperly engages in political campaign intervention, the charity’s tax-exempt status under section 501(c)(3) may be revoked, in which case the IRS will notify the public that contributions to the entity no longer are tax-deductible. Moreover, penalty excise taxes may be imposed by the IRS under section 4955 in addition (or as an alternative) to revocation of tax-exempt status. When penalty excise taxes are imposed under section 4955 as a result of improper political campaign intervention, disclosure of this fact is required on the charity’s annual information return, which is filed with the IRS and which must be made available to the public upon request.<sup>6</sup>

#### *Lobbying by charities*

As a general rule, section 501(c)(3) provides that no more than an insubstantial amount of the activities of a charity may be attempting to influence legislation. More specifically, the Code and regulations contain three sets of overlapping rules governing such “lobbying” efforts by charities. One set of rules applies to public charities that elect to be governed by a specific, numeric test (based on dollar amounts of expenditures by the charity) to determine whether their lobbying activities are substantial.<sup>7</sup> Another set of rules applies to charities that choose to be subject to a facts-and-circumstances test of whether their lobbying activities are substantial relative to their other activities.<sup>8</sup> A third set of rules applies to private foundations, which generally are subject to penalty excise taxes on their lobbying expenditures even if the foundation’s lobbying activities are not so substantial as to jeopardize its tax-exempt status.<sup>9</sup>

The definition of “lobbying” for purposes of section 501(c)(3) is essentially the same under the three sets of rules governing charities. In short, “lobbying” includes directly contacting members of a legislative body (or their staffs) to support or oppose legislation (so-called “direct lobbying”), as well as urging the public to contact legislative bodies, or otherwise attempting to influence public opinion, with respect to specific legislation (so-called “grassroots lobbying”). All facts and circumstances surrounding a communication generally are taken into account in determining whether “lobbying” has occurred, although discussions of broad social or policy issues (even issues likely to be addressed by a legislature) generally do not constitute “lobbying” for purposes of section 501(c)(3) if the discussion does not advocate for or against a specific legislative proposal.

For communications that fall within the section 501(c)(3) general definition of “lobbying,” exceptions are provided when an organization makes available certain nonpartisan analysis, study, or research, or provides technical advice to a governmental body in response to a written request.<sup>10</sup> In addition, for purposes of section 501(c)(3), “lobbying” does not include certain communications between a public charity and its members, nor does the term include direct lobbying by a charity with respect to legislation which might affect the existence, powers and duties, tax-exempt status, or deduction of contributions to the organization (so-called “self-defense lobbying”).<sup>11</sup>

Under current law, charities disclose their lobbying activities to the IRS and the general public by reporting on their annual information return (Form 990) the

<sup>5</sup> See, e.g., Rev. Rul. 78-248, 1978-1 C.B. 154.

<sup>6</sup> See section 6104(d) and Treas. Reg. Sec. 301.6104(a)-3(a).

<sup>7</sup> See sections 501(h) and 4911, which provide that an “electing” charity’s total lobbying expenditures in any year may not exceed 20% of the first \$500,000 of the organization’s exempt purpose expenditures, with decreasing percentages for additional exempt purpose expenditures (subject to a \$1 million cap for total lobbying expenditures). A separate limit equal to 25% of the overall permissible lobbying amount applies to grass roots lobbying.

<sup>8</sup> See, e.g., Treas. Reg. Sec. 1.503(c)(3)-1(c)(3)(ii); *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974).

<sup>9</sup> See section 4945(d)(1) and (e).

<sup>10</sup> The “nonpartisan analysis” exception may apply, even if the communication advocates a particular position, provided that there is a sufficiently full and fair exposition of the facts to enable the recipient to form an independent opinion and the communication does not “directly encourage” the recipient to take action. See Treas. Reg. Sec. 56.4911-2(c)(1)(ii) and (vi).

<sup>11</sup> See sections 4911(d) and 4945(e).

amount of their lobbying expenditures for the taxable year. In addition, charities which elect to be subject to the section 501(h) numeric test of “substantiality” must allocate their expenditures between “direct” and “grass roots” lobbying. Non-electing charities must disclose their general methods of lobbying, such as the use of media advertisements or direct contacts with legislators, and the amounts expended using each method. In addition, to the extent that a charity engages in non-partisan analysis of legislation as part of its major program services, such activities are described on the Form 990.

If a charity improperly engages in “substantial” lobbying, the charity’s tax-exempt status under section 501(c)(3) may be revoked, and such a sanction would be disclosed to the general public. Moreover, penalty excise taxes may be imposed by the IRS under sections 4911 or 4912 in cases of excess lobbying expenditures, and imposition of these penalties would be reported on the charity’s Form 990.

#### *Disclosure of contributors to charities*

The annual information return (Form 990) required to be filed by a charity with the IRS and made publicly available contains a variety of information about the charity’s operations for the taxable year, including a description of its major programs, gross income and expenses, assets and liabilities, and total contributions received.<sup>12</sup> When filing this return with the IRS, charities also attach a list that identifies the names and addresses of all substantial contributors (generally meaning persons who contribute \$5,000 or more to the charity during the year). However, section 6104(d)(3) expressly provides that, in the case of a public charity, public disclosure is not required of its contributor list. The Form 990 is required to be filed within four and one-half months following the end of the organization’s taxable year.<sup>13</sup> An organization that fails to file a complete and accurate Form 990 is subject to a penalty of \$20 for each day the failure continues, up to a maximum penalty per return of \$10,000 or (if less) five percent of the organization’s gross receipts for the year.<sup>14</sup> Similar penalties also may be imposed if an organization fails to make its Form 990 (or its exemption application) publicly available.<sup>15</sup>

### NON-CHARITIES

#### *Exempt Status*

Nonprofit organizations that are described in section 501(c) but which are not charities include section 501(c)(4) social welfare organizations, section 501(c)(5) labor and agricultural organizations, section 501(c)(6) business leagues, and section 501(c)(7) social clubs. These non-charities generally are exempt from tax on dues and contributions, related-function income, and investment income, but are subject to tax on certain unrelated business income.<sup>16</sup> Contributions to non-charities generally are not deductible to the donor for Federal income, estate, or gift tax purposes.<sup>17</sup> However, in some instances, contributions or dues may be deductible by the payor as a trade or business expense, provided that the payment is not allocable to political campaign or lobbying activities conducted by the recipient organization.<sup>18</sup>

<sup>12</sup>The annual information-reporting requirement does not apply to churches and small charities which normally have annual gross receipts below \$25,000. See section 6033(a)(2); Rev. Proc. 83-23, 1983-1 C.B. 687.

<sup>13</sup>An organization may request up to two 90-day extensions of time to file its Form 990 (for a maximum extension of up to six months).

<sup>14</sup>Section 6652(c)(1)(A). Higher penalties (i.e., \$100 per day, up to a maximum of \$50,000) apply to organizations having annual gross receipts over \$1 million.

<sup>15</sup>Section 6652(c)(1)(C) and (D).

<sup>16</sup>Certain organizations—such as social clubs described in section 501(c)(7)—are exempt from tax on dues and certain other amounts paid by members, but are subject to tax on their investment income and any income received from non-members.

<sup>17</sup>There are limited exceptions to this general rule for certain contributions made to war veterans groups, domestic fraternal societies, and certain nonprofit cemetery companies. See sections 170(c)(3), (c)(4), and (c)(5). The IRS’ position is that, in the absence of a specific statutory exception, gifts to non-charities are subject to the Federal gift tax. See Rev. Rul. 82-216 C.B. 1982-1 C.B. 220.

<sup>18</sup>See section 162(e)(3). Corporations and businesses generally are prohibited by section 162(e)(1) from deducting political campaign and lobbying expenditures; and section 162(e)(3) ensures that section 162(e)(1) is not circumvented by a business simply making dues payments to a membership organization which, in turn, conducts political campaign or lobbying activities on behalf of its members. However, a non-charity such as a business league may elect to pay a “proxy” tax on its political campaign or lobbying expenditures, in which case dues paid by its

Continued

### *Political campaign intervention*

Non-charities generally are not restricted by the Internal Revenue Code from engaging in political campaign activities. However, political campaign activities cannot be the primary activities of an entity described in section 501(c), such as a section 501(c)(4) social welfare organization.<sup>19</sup> If the primary activities of an organization are conducting or funding political campaign activities, such an organization may be eligible for the limited tax-exempt status under section 527 (see below).

To the extent that a non-charity engages in *any* political campaign activities, the organization (or a separate segregated fund through which it funds such activities) is subject to tax on the lesser amount of its investment income or the amount expended on political campaign activities.<sup>20</sup> The objective of this rule is to prevent organizations from using tax-free investment income to fund political campaign intervention. For this purpose, the test for determining whether political campaign activities have been funded or conducted by the organization is generally the same as for purposes of section 501(c)(3)—that is, the question is whether, based on all the surrounding facts and circumstances, there has been an attempt to influence an election for public office by supporting or opposing one or more candidates.<sup>21</sup>

Non-charities must indicate on their Form 990 the amount of expenditures for political campaign intervention and indicate whether they filed a Form 1120-POL, which is required if their net investment income and political campaign expenditures both exceed \$100. Form 1120-POL is a one-page form indicating the amount of investment income, expenses attributable that income, and the amount of tax due. There is no listing on the Form 1120-POL of contributors to the organization or recipients of disbursements. In contrast to the Form 990, which is an information return, the Form 1120-POL is a tax return that is not publicly available. Form 1120-POL is required to be filed within two and one-half months after the end of the organization's taxable year.<sup>22</sup>

### *Lobbying activities*

Non-charities described in section 501(c) are not subject to any specific Internal Revenue Code provision that restricts their lobbying activities. Indeed, lobbying may be the primary activity for some tax-exempt organizations, such as a social welfare organization or a business league. In general, the only theoretical limit is that the lobbying activities must somehow further the entity's nonprofit purposes.

Non-charities with members who may be deducting their dues payments as business expenses are required to indicate on their Form 990 the amount of their lobbying expenditures, which would be non-deductible if directly incurred by the member. Other non-charities generally do not specifically report lobbying expenditures on the Form 990, but may describe their lobbying activities if part of a major program of the organization.

### *Disclosure of contributors*

As with charitable organizations, non-charities described in section 501(c) generally must report on their Form 990 the total amount of dues and contributions received by the organization during the taxable year. In addition, non-charities provide a list of their major contributors (generally meaning persons who make gifts of \$5,000 or more during the year) to the IRS, but this list is not publicly available.

### *Section 527 political organizations*

Section 527 governs the tax treatment of “political organizations,” meaning a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures (or both) for an “exempt function.” Section 527 uses the term “exempt function” rather than “political campaign intervention,” although there is significant overlap in the tax code meaning of these terms. Section 527(f)(2) defines the term “exempt function” as—

“the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Pres-

members could be deducted as a business expense without regard to the political campaign or lobbying expenditures made by the organization. See section 6033(e).

<sup>19</sup> See Rev. Rul. 81-95, 1981-1 C.B. 332.

<sup>20</sup> See section 527(f).

<sup>21</sup> See Rev. Rul. 81-95, *supra*.

<sup>22</sup> An organization may request a six-month extension of time to file Form 1120-POL.

idential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.”

Section 527 clarifies the tax treatment of “political organizations” by providing that contributions (and certain political fundraising receipts) received by the entity (or fund) are not subject to an entity-level tax, yet the entity’s (or fund’s) investment income and any income from events that are not political in nature is subject to tax, generally at the highest corporate income tax rate.<sup>23</sup> Moreover, another section of the Code—section 2501(a)(5)—specifically provides that contributions to section 527 political organizations are exempted from the Federal gift tax.<sup>24</sup>

In determining whether a particular activity constitutes “exempt function” activity for purposes of section 527, the IRS examines all facts and circumstances to determine if there is a sufficient nexus between the activity and the election of an individual to a public office.<sup>25</sup> The IRS generally applies the same standard used to test whether particular activities amount to “political campaign intervention” for a section 501(c) organization when determining whether “exempt function” activities are conducted for purposes of section 527.<sup>26</sup> In both the section 501(c) and section 527 context, the scope of campaign-related activities is broader than the definition of “express advocacy” under the Federal Election Campaign Act (FECA)<sup>27</sup> (see discussion below). Thus, the section 527 definition of “political organizations” covers not only traditional political parties and candidate committees subject to regulation under the FECA, but *also* covers other organizations (and unincorporated funds) which are organized and operated primarily to conduct activities in an attempt to influence an election—at the Federal, State, or local level—even though these organizations may not engage in “express advocacy” in the FECA sense. In other words, section 527 covers “political organizations” that are commonly referred to as “issue advocacy” organizations for Federal election law purposes,<sup>28</sup> because such organizations conduct (or fund) biased voter education efforts, targeted voter-registration efforts, or grassroots lobbying intended to influence an election, although the organization does not expressly advocate the election (or defeat) of a particular candidate. The IRS has ruled that, because such biased campaign-related activities constitute “political campaign intervention” under long-standing interpretations of section 501(c)(3), an entity or fund organized and operated primarily to conduct such activities is treated as a section 527 entity.<sup>29</sup>

To ensure that tax-exempt organizations which conduct some political campaign activities but not as their *primary* activity—e.g., a social welfare organization—cannot use tax-free investment income to fund such activities, section 527(f) imposes a tax on the organization’s investment income, up to the amount of its “exempt function” expenditures within the meaning of section 527. This tax imposed under sec-

<sup>23</sup> A special rule provides that principal campaign committees of candidates for Congress are subject to tax at graduated corporate rates. Section 527(h).

<sup>24</sup> If, however, a contribution is made of appreciated property to a section 527 entity, then the contributor is treated as if he sold the property at its fair market value and contributed the proceeds to the section 527 entity. Section 84. In this way, built-in (untaxed) gains cannot be used to fund political campaign activities.

<sup>25</sup> See Hill, Frances R. “Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle,” *Tax Notes*, at 387–402 (January 17, 2000).

<sup>26</sup> See, e.g., PLR 9808037 (Nov. 21, 1997) (“It follows that any activities constituting prohibited political intervention by a section 501(c)(3) organization are activities that must be less than the primary activities of a section 501(c)(4) organization, which are, in turn, activities that are exempt functions for a section 527 organization.”); PLR 199925051 (March 29, 1999) (“similar analysis” applies under sections 501(c)(3), 501(c)(4), and section 527 to determine if “voter guides cross over the line from simply educating voters to attempting to influence their votes”).

<sup>27</sup> 2 USC 431 *et seq.*

<sup>28</sup> There is no statutory or regulatory definition of “issue advocacy” for FECA purposes. The term “issue advocacy” is used in the FECA context to describe all political activities that fall *outside* the scope of “express advocacy.” See Hill, *supra*, at 395.

<sup>29</sup> In recent years, a number of entities have sought recognition from the IRS of their section 527 status by describing their intended election-related activities and *acknowledging* that their primary objective was to influence elections, although the organizations were specifically prohibited by their organizational documents (or a resolution passed by the governing board) from *expressly* advocating the election or defeat of any candidate. Based on such representations from the organizations, the IRS concluded that they were “political organizations” under section 527. See, e.g., PLR 9725036 (March 24, 1997) (although factual and educational, the content, timing, and targeting of the material was intended to influence the electoral process); PLR 199925051 (March 29, 1999) (materials distributed and techniques used resemble public education and issue advocacy materials and techniques often used by section 501(c)(3) and 501(c)(4) organizations; however, because materials and techniques were admittedly designed to influence elections and were biased in their presentation, they constituted section 527 “exempt function” activities).

tion 527(f) operates so that section 527 organizations and section 501(c) entities receive consistent treatment with respect to their campaign-related activities.<sup>30</sup>

Political organizations described in section 527, as well as section 501(c) organizations, are required to file a Form 1120-POL with the IRS for any taxable year in which the organization has both investment income and “exempt function” expenditures (within the meaning of section 527) exceeding \$100. As mentioned previously, Form 1120-POL is a one-page form which does not list contributors to the organization, nor does it identify the recipients of disbursements made by the organization. The Form 1120-POL is not disclosable to the general public. In contrast to charities and non-charities described in section 501(c), political organizations do not file an annual information return (Form 990).

#### FEDERAL ELECTION LAW RULES

The Federal Election Campaign Act (FECA) requires public disclosure of Federal campaign finances, limits campaign contributions by individuals, political parties, and other special interests, and regulates spending in campaigns for Federal office in order to inform the electorate and prevent corruption of the political process.<sup>31</sup>

##### *Contribution limits*

The FECA prohibits certain individuals and entities (such as corporations, labor organizations, Federal government contractors, and foreign nationals) from making contributions or expenditures to influence Federal elections. In addition, the FECA generally limits the amounts that may be contributed by individuals and groups to candidates (and their authorized committees), political party committees, and other political committees.<sup>32</sup> However, the FECA dollar-amount contribution limits do not apply to so-called “independent expenditures,” which are expenditures for communications (such as newspaper, TV, or direct mail advertisements) which expressly advocate the election or defeat of a clearly identified candidate, but which are made independently from the candidate’s campaign (i.e., the expenditure is not made with the cooperation or consent of, or at the request or suggestion of, the candidate or the campaign).<sup>33</sup> Although there is no limit on the amount of such “independent expenditures,” the law requires all persons making such independent expenditures to report them to the Federal Election Commission (FEC) and to disclose the sources of the funds they used.<sup>34</sup> In contrast with independent expenditures, expenditures which are coordinated with the candidate’s campaign are, for FECA purposes, treated as in-kind contributions subject to the general contribution limits.<sup>35</sup>

##### *Reporting and disclosure*

The FECA requires political committees (including political party committees, campaign committees, and political action committees (PACs)) to register and file periodic reports with the FEC disclosing the funds they raise and spend.<sup>36</sup> Each political committee is required to file a statement of organization with the FEC, generally within 10 days after establishment. The statement must include the name and address of the committee, the names and addresses of its Treasurer<sup>37</sup> and the custodian of its books and accounts. Thereafter, each political committee must file periodic reports of its receipts and disbursements. During an election year, a political committee generally has the option of filing quarterly or monthly reports, and must also file special pre-and post-election reports. During a non-election year, quarterly filers automatically switch to a semi-annual reporting schedule.<sup>38</sup>

Each report must disclose the amount of cash on hand at the beginning of the reporting period, the committee’s total receipts (for the reporting period and the calendar year to date), including the total contributions received from political commit-

<sup>30</sup> For purposes of the section 527(f) tax, certain separate segregated funds, such as a PAC, established by a section 501(c) organization are treated as separate organizations (sec. 527(f)(3)).

<sup>31</sup> See *Buckley v. Valeo*, 424 U.S. 1 (1976).

<sup>32</sup> 2 USC 441a, 441b, 441c, 441e.

<sup>33</sup> Individuals and entities (such as corporations) that are prohibited from making contributions to influence Federal elections are likewise prohibited from making “independent expenditures.”

<sup>34</sup> 2 USC 434(b) and (c). See also *Colorado Republican Federal Campaign Committee v. FEC*, 518 U.S. 604 (1996).

<sup>35</sup> 2 USC 441a(a)(7)(B)(i).

<sup>36</sup> 2 USC 431(17), 433, 434.

<sup>37</sup> FECA requires each political committee to designate a Treasurer, who must authorize all expenditures and keep detailed records of all contributions received and disbursements made on behalf of the committee. 2 USC 432.

<sup>38</sup> 2 USC 434(a)(4). The reporting schedule for authorized committees of a candidate is described in 2 USC 434(a)(2) and (3).



tees and other sources, and an itemized list of contributors, including each person (other than a political committee) whose aggregate contributions during the calendar year exceed \$200.<sup>39</sup> Each report must also disclose the committee's total disbursements (for the reporting period and the calendar year to date), including all contributions to candidates and other political committees, and all independent expenditures. The report must identify each person who receives aggregate disbursements of \$200 or more during the calendar year, and report the date, amount, and purpose of each disbursement.<sup>40</sup> The FEC makes all statements of organization and periodic reports available to the public within 48 hours after receipt.<sup>41</sup>

In addition to required disclosure by political committees, the FECA requires any person who makes independent expenditures in an aggregate amount of more than \$250 during a calendar year to report to the FEC detailed information regarding the identities of contributors, and the amount and purpose of such independent expenditures.<sup>42</sup> In addition, any person who finances communications expressly advocating the election or defeat of a clearly identified candidate, or solicits any contribution through public advertisements or direct mail must indicate who paid for the communication and whether it is authorized by the candidate or authorized committee.<sup>43</sup>

Since 1998, the FEC has permitted filers to submit reports electronically by modem or via the Internet. The FEC scans all reports filed with the FEC to make digital images of the documents, and makes the digital images available in the FEC's Public Records Office and on the Commission's Internet web site.<sup>44</sup> Also available on the FEC's web site is a searchable database of campaign finance information.<sup>45</sup> Visitors may search this database for information regarding contributions by individuals and political committees to House, Senate, and Presidential campaigns, political parties, and PACs in the 1997–98 and 1999–2000 election cycles. By querying this database, visitors can search for contributions made by a specific individual, contributions received or made by a specific political committee, and contributions received by a specific campaign. Results of these queries are linked to the imaging system so visitors can view the actual financial reports filed by the campaigns or committees.

#### *Express advocacy standard*

Although some uncertainty remains, the current prevailing view of the courts appears to be that, in the absence of coordination with a candidate's campaign, only communications that contain express words advocating the election or defeat of a candidate—such as “vote for,” “support,” “defeat,” and certain other “magic words”—are subject to the requirements of FECA, including the restrictions on contributors eligible to fund such communications, the contribution limits, and public disclosure requirements for funds raised and spent on such communications.<sup>46</sup> Accordingly, individuals, entities, and groups—including section 527 political organizations—that attempt to influence Federal elections, but that refrain from “express advocacy,” may be able to avoid the FECA reporting and disclosure requirements.<sup>47</sup>

<sup>39</sup> For each contribution, the committee must report the full name and address of the contributor, the contributor's occupation and employer, the date of receipt and the amount of each contribution, and the aggregate contributions received from the same contributor during the calendar year. 2 USC 431(13) and 434(b)(3).

<sup>40</sup> In the case of independent expenditures, the report must also state whether the independent expenditure is in support of, or in opposition to, a candidate, as well as the name and office sought by the candidate, and a certification, under penalty of perjury, whether the expenditure is made in cooperation, consultation, or concert with any political committee, or at the request or suggestion of any candidate or authorized committee. 2 USC 434(b)(6)(B).

<sup>41</sup> Federal Election Commission, *Twenty Year Report* at 4 (1995).

<sup>42</sup> 2 USC 434(c).

<sup>43</sup> 2 USC 441d.

<sup>44</sup> The FEC's Public Records Office continues to make available microfilm and paper copies of these reports. See Federal Election Commission, *Annual Report 1998*, at 7–9.

<sup>45</sup> The Internet address is: [www.fed.gov/finance-reports.html](http://www.fed.gov/finance-reports.html)

<sup>46</sup> See *Maine Right to Life Committee v. FEC*, 98 F.3d 1 (1st Cir. 1996); *FEC v. Christian Action Network*, 92 F. 3d 1178 (4th Cir. 1997); *FEC v. Christian Coalition*, 52 F. Supp. 2d 45 (D.D.C. 1999). But see *FEC v. Furgatch*, 807 F.2d 857 (9th Cir. 1987) (“express advocacy” subject to regulation under FECA need not include any of the words listed in *Buckley* but “must, when read as a whole, and with limited reference to external events, be susceptible of no other reasonable interpretation but as an exhortation to vote for or against a specific candidate”). See also *Buckley v. Valeo*, 424 U.S. at 44, n.52 (limiting the application of certain provisions of the FECA to “communications containing express words of advocacy of election or defeat, such as ‘vote for,’ ‘elect,’ ‘support,’ ‘cast your ballot for,’ ‘Smith for Congress,’ ‘vote against,’ ‘defeat,’ ‘reject.’”) <sup>47</sup>

<sup>47</sup> To avoid the FECA reporting requirements, a section 527 organization must also avoid making contributions directly to candidate committees or making coordinated expenditures. 2

## LOBBYING DISCLOSURE ACT

The Lobbying Disclosure Act<sup>48</sup> requires certain individuals and organizations that lobby the Federal government (either on behalf of clients or on the organization's own behalf) to register with the Clerk of the House of Representatives and the Secretary of the Senate, and to file semi-annual reports detailing their lobbying activities. The stated purpose of the Act is to promote public awareness of efforts by paid lobbyists to influence the public decisionmaking process of the legislative and executive branches of the Federal government.<sup>49</sup>

In general, an organization that engages in lobbying activities on its own behalf is subject to the registration and reporting requirements of the Act if it (1) has at least one employee who spends 20 percent of his or her time on lobbying activities and (2) expends (or expects to expend) more than \$20,500<sup>50</sup> for lobbying activities in any six month period.<sup>51</sup> Among the information required to be reported semi-annually are the general areas (e.g., communications, education, health issues) and specific issues (e.g., specific bills before Congress or specific executive branch actions) on which the organization lobbied, the Houses of Congress or Federal agencies contacted, and a good faith estimate of the total expenses incurred in carrying out the lobbying activities. The registration forms (Form LD-1) and semi-annual reports (Form LD-2) are publicly available.<sup>52</sup>

Lobbying is broadly defined under the Act to include any oral or written communication with certain Federal executive or legislative branch officials<sup>53</sup> regarding (1) the formulation, modification, or adoption of Federal legislation, (2) the formulation, modification or adoption of a federal rule, regulation, executive order, or any other program, policy or position of the Federal government, (3) the administration or execution of a Federal program or policy, and (4) the nomination or confirmation of a person to a position that is subject to Senate confirmation.<sup>54</sup> The Act excepts from the definition of lobbying certain categories of communications, including communications by churches, and various communications of a public nature (such as testimony before a Congressional committee, communications made on the public record in a public proceeding, and mass media communications).<sup>55</sup>

To reduce the recordkeeping burden on organizations (such as for-profit entities, certain tax-exempt membership organizations, and certain public charities) that are already required under the Internal Revenue Code to track expenditures for lobbying,<sup>56</sup> the Act generally permits such organizations to use the Internal Revenue Code definition for purposes of reporting the *amount* of their lobbying expenditures

USC 441a(a)(8) and 441a(a)(7)(B). It is unclear whether a section 527 organization that engages in both "express advocacy" and "issue advocacy" would be treated as a "political committee" under the FECA and, thus, subject to disclosure rules with respect to "soft money" contributions it receives, even though no limits as to source or amount apply to such contributions. See Hill, *supra* at 395, 400–01.

<sup>48</sup> 2 USC 1601 *et seq.*

<sup>49</sup> In general, the Act is a disclosure statute and does not restrict lobbying activity. However, the Act provides that section 501(c)(4) organizations that engage in lobbying activities are not eligible to receive Federal award, grant, or loan funds. 2 USC 1611.

<sup>50</sup> This amount is indexed for inflation. 2 USC 1603.

<sup>51</sup> Registration is generally required within 45 days after an organization first makes a lobbying communication. Each registrant must disclose its name, address, and a description of its business, the general areas in which it expects to engage in lobbying, and the identity of certain organizations that contribute to and control its lobbying activities, and certain other information. 2 USC 1603.

<sup>52</sup> 2 USC 1604, 1605.

<sup>53</sup> To constitute lobbying under the Act, the communication must be directed to Members of Congress, Congressional staff and certain other legislative branch employees, the President, the Vice President, employees of the Executive Office of the President, and certain executive branch officials and employees, political appointees, and certain high-ranking members of the uniformed services. 2 USC 1602(3) and (4).

<sup>54</sup> The definition of lobbying under the Act is both more inclusive and less inclusive than the Internal Revenue Code definition. For example, although the Act does not apply to "grassroots" lobbying or lobbying at the State or local level, it applies to efforts to influence not only legislation, but also a broad range of policy-related matters at the Federal level.

<sup>55</sup> 2 USC 1602(8). Unlike section 4911(d) of the Internal Revenue Code, the Act contains no specific exception for "self-defense" lobbying. However, depending on the form of the communication, a self-defense communication may fall within one of the other exceptions under the Act.

<sup>56</sup> For example, for-profit entities must keep track of lobbying and political expenditures, which are not deductible under section 162(e) of the Code. Tax-exempt membership organizations that receive deductible dues must keep track of the portion of membership contributions attributable to lobbying and political activities, and pay a proxy tax or inform members what portion of their dues is nondeductible under section 162(e). See section 6033(e). Public charities that have made an election under section 501(h) of the Code must track expenditures for "attempts to influence legislation" as defined under section 4911(d).

during the semi-annual reporting period.<sup>57</sup> However, such organizations *must* use the Act's definition of lobbying for purposes of providing a *narrative description* of their lobbying activities before the legislative branch.<sup>58</sup>

#### PROPOSALS FOR INCREASED DISCLOSURE BY SECTION 527 ENTITIES

Several bills have been introduced in the 106th Congress to expand the reporting and disclosure requirements governing section 527 political organizations. The bills, however, generally would not apply to section 527 organizations that attempt to influence State and local, but not Federal, elections. Some of these proposals would amend the Internal Revenue Code to require section 527 organizations to file periodic disclosure reports with the IRS and make such reports publicly available.<sup>59</sup> The information to be disclosed would parallel the contents of disclosure reports currently filed under FECA with respect to "express advocacy"—that is, the name, address, occupation, and name of employer of each person who contributed more than \$200 to the organization during the reporting period, and the name and address of each person to whom disbursements were made of more than \$200 during such period.<sup>60</sup> These proposals generally follow the reporting periods and multiple filing deadlines under the current-law FECA disclosure regime (which vary based on whether a Federal election or primary is held during the year). At least one bill would require the IRS to develop procedures for submission in electronic form of disclosure reports.<sup>61</sup> Some proposals would allow political organizations the option of filing disclosure reports with the FEC as an alternative to filing such reports with the IRS. Other introduced bills take a different overall approach. These proposals would not amend the Internal Revenue Code, but instead would modify the Federal election laws to require periodic disclosure to the FEC of contributors to, and expenditures made by, section 527 political organizations.<sup>62</sup>

To prevent avoidance of the disclosure objectives, one proposal provides that the new disclosure requirements to be incorporated into the Internal Revenue Code would apply to all organizations that satisfy the section 527 definition of a political organization "without regard to whether such organization claims a tax exemption under section 527."<sup>63</sup> This would prevent a political organization from evading the new disclosure requirements, while claiming essentially the same tax treatment under general principles of the Code outside of section 527 (as discussed below). Thus, the new disclosure requirements would apply to all organizations (and funds) that are organized and operated primarily to influence Federal elections. However, other than H.R. 4621, which directly amends the FECA (as well as the Federal Communications Act<sup>64</sup>), the introduced bills referred to above generally would *not*

<sup>57</sup> 2 USC 1610. Although "non-electing" public charities must also track expenditures for lobbying as defined under section 501(c)(3), the Act does not provide a similar exception for them. The special rule allowing certain organizations to report expenditures using the Internal Revenue Code definitions does not apply to lobbyists paid by outside clients.

<sup>58</sup> Non-electing public charities and private foundations are required to use the Act's definition for *all* purposes. Because the lobbying activities covered by the Act are different from the "attempts to influence legislation" which are prohibited under section 4945(e) of the Code, private foundations may be required to register under the Act.

<sup>59</sup> See H.R. 4168 (Doggett) and S. 2583 (Lieberman).

<sup>60</sup> See H.R. 4168, which would also require reports to be filed shortly after a political organization is established, including identifying all persons who are in a position to "exercise substantial direct or indirect influence" over the organization. Similarly, S. 2583 would require notification to be filed with the IRS shortly after the organization is established, identifying officers, key employees, and related entities. S. 2583 would require disclosure of the identity of persons who receive disbursements from the organization only if they receive \$500 or more during the calendar year.

<sup>61</sup> See H.R. 4168.

<sup>62</sup> See H.R. 4621 (Castle). Another bill, H.R. 3688 (Moore), would amend section 527 of the Internal Revenue Code to require that political organizations which attempt to influence Federal elections must certify to the IRS that they are in compliance with FECA disclosure requirements, *and* the bill also would amend FECA to impose specific statutory disclosure requirements for any entity that claims section 527 status for Internal Revenue Code purposes. See also S. 2582 (Lieberman), which would not add any specific disclosure rules to the Internal Revenue Code but would simply amend section 527 to provide as a general rule that a political organization which attempts to influence Federal elections is described in section 527 only if it is a "political committee" for purposes of FECA.

<sup>63</sup> H.R. 4168.

<sup>64</sup> The amendments made by H.R. 4621 to the Communications Act would require disclosure as part of certain broadcast political advertisements of the name of the person(s) responsible for such advertisements, and would also make publicly available information regarding donors to entities which place such advertisements.

apply to entities, tax-exempt or taxable, that engage in some campaign-related activities but not as their *primary activity*.<sup>65</sup>

The sanction for non-disclosure would vary under the introduced bills. Under H.R. 4168, the penalty for non-disclosure would be the same as that imposed under current-law on large organizations that fail to file an accurate Form 990.<sup>66</sup> In addition, under H.R. 4168, the gift tax exclusion under current-law section 2501(a) for contributions made to political organizations would not apply to contributions made to organizations that are not in substantial compliance with the bill's disclosure requirements. Under S. 2583, the penalty for inadequate disclosure would be that all the political organization's contributions (and other political fundraising receipts), minus the costs directly connected with the production of such income, would be subject to tax. Under other bills, the consequences of nondisclosure are unclear, because these bills would simply deny section 527 status to entities that are not subject to the FEC reporting, which would not necessarily result in any adverse tax consequences (see below).<sup>67</sup>

#### ISSUES PRESENTED BY CURRENT LAW

##### *Tax Treatment*

Section 501(c) nonprofits and 527 organizations generally receive the proper tax treatment under current law with respect to their advocacy activities. The current-law tax rules provide appropriate and consistent treatment of political organizations and other organizations that engage in electioneering activities by generally ensuring that only after-tax dollars are used to fund such collective activities. Contributions to section 527 organizations are not deductible for Federal income tax purposes, and even in cases where contributions to a section 501(c) organization may be deductible as a business expense, no deduction is allowed (or a proxy tax is imposed) for the portion allocable to political activities.

The limited tax-exempt status provided by section 527 for the political entity itself does not represent a significant tax subsidy. Arguably, section 527 merely codifies the same tax treatment that would result under general tax principles—i.e., contributions to political organizations would be excludable as “gifts” under section 102 or under a common-law “conduit” theory.<sup>68</sup> If, instead of pooling their funds, political supporters collectively decided to underwrite advocacy activities but each supporter separately wrote a check to pay for an advertising campaign, no additional level of tax would be imposed on that collective activity. However, individuals who used their investment income to pay for political advertising would pay tax on that income. Section 527 produces the same result by taxing all investment income of political organizations, as well as taxing other nonprofit organizations on their investment income to the extent they incur political campaign expenses. In effect, the tax consequences under current-law rules generally are the same regardless of whether electioneering activities are conducted collectively through a nonprofit entity or by a group of individuals without the use of a separate legal entity or segregated fund.<sup>69</sup>

If there is any significant tax subsidy granted to section 527 political organizations, it is because contributions (if greater than the general \$10,000 gift-tax exclu-

<sup>65</sup> Another recently introduced bill, S. 2742 (Smith), would impose on section 527 entities disclosure requirements similar to H.R. 4168, and the bill also would impose on section 501(c)(5) labor (but not agricultural) organizations and section 501(c)(6) business leagues similar disclosure requirements if the organization spends more than \$25,000 during the calendar year for communications to the general public which mention an election for Federal office, a candidate for Federal office, an individual holding Federal office, or a political party, or which contain the likeness of such candidate or individual.

<sup>66</sup> See footnote 14 *supra*.

<sup>67</sup> See H.R. 3688 and S. 2582.

<sup>68</sup> See H.Rpt. No. 1502, 93rd Cong., 2nd Sess. at 104 (1974)(legislative history to section 527 indicating that conduct and financing of political activity generally is not a trade or business); Rev. Proc. 68-19, 1968-1 C.B. 810(treating receipts of political organizations as “gifts”); Rev. Rul. 74-21, 1974-1 C.B. 14 (modified and clarified in Rev. Rul. 74-475, 1974-2 C.B. 22)(political organizations should be taxed on their investment income). However, some of the “exempt function” income received by section 527 entities from political fundraising activities where there is a *quid pro quo* transaction (such as with income from bingo games and sales of political material) would, in the absence of the specific statutory provision, not be exempt from tax at the entity level as “gifts” or under a “conduit” theory. Under general tax principles, the question with a political organization would be what expenses could be claimed against such income as off-setting deductions.

<sup>69</sup> The Code provides similar treatment for collective recreational activities conducted through section 501(c)(7) social clubs, which likewise receive non-deductible contributions, do not pay tax on member dues, but do pay tax on their investment income.

sion amount) are provided a special exemption from the Federal gift tax under section 2501(a)(1)(5). Absent section 2501(a)(1)(5), contributions to such organizations would technically be subject to the gift tax, although it is not clear under common law whether all political contributions would be viewed as gratuitous gifts subject to the gift tax regime.<sup>70</sup> Nonetheless, the presence of a gift tax subsidy may provide the basis for regulation of constitutionally protected advocacy activities conducted by nonprofit organizations.<sup>71</sup>

#### *Definitional issues*

Under the Internal Revenue Code, difficult line-drawing sometimes is required under current law to determine whether particular advocacy activities, taking into account all facts and circumstances, constitute implied political campaign intervention. The tax code consistently uses such a facts-and-circumstances test for all non-profits to determine whether political campaign intervention has occurred. The IRS recognizes that material may “reflect a dual character” in that it may contain elements of grass roots lobbying with respect to legislation and, at the same time, be biased in favor of a candidate.<sup>72</sup> This presents subtle line-drawing problems in particular cases, similar to the issues that arise with charities, as well as with taxable businesses, when trying to distinguish “lobbying” with respect to legislation from discussions of broad social issues.<sup>73</sup>

There may have been the implicit assumption in 1974, when section 527 was enacted, that political organizations generally would be subject to the FECA regime, which had been enacted just three years earlier and also referred to contributions and expenditures for “the purpose of influencing any election.”<sup>74</sup> However, in the aftermath of the Supreme Court’s 1976 decision in *Buckley v. Valeo*, the scope of the FECA has been shrinking. As Federal courts during the mid-and late-1990’s adopted a narrow interpretation of communications covered by the FECA, it became easier for entities to admit before IRS that they had an agenda to influence elections (and thereby obtain certainty in their tax law treatment) yet still claim that they were immune from FEC regulation because they did not engage in “express advocacy.”

The narrow, “express advocacy” standard used by some courts in applying the FECA regime avoids the difficult and sometimes subtle determinations that are required under a facts-and-circumstances approach. In the FECA context—which does not involve a tax subsidy issue—it remains an open question whether the “express advocacy” standard is constitutionally mandated.<sup>75</sup> However, the “express advocacy” standard is inherently under-inclusive; and if used in the tax code, effectively would

<sup>70</sup>With respect to political contributions made prior to the enactment of sections 527 and 2501(a)(5), two Federal courts held that such contributions were not subject to the Federal gift tax, under the rationale that the political organization receiving the contribution may be viewed as the means to the end of the contributor, who wishes to express shared political views. See *Carson v. United States*, 641 U.S. 864 (10th Cir. 1981); *Stern v. United States*, 436 F.2d 1327 (5th Cir. 1971).

<sup>71</sup>See *Regan v. Taxation With Representation*, 461 U.S. 540 (1983)(upholding constitutionality of lobbying restrictions on charities); *Cammarano v. United States*, 358 U.S. 498 (1954)(denial of business-expense deductions for lobbying is constitutional).

<sup>72</sup>See, e.g., PLR 9725036 (March 24, 1997); PLR 199925051 (March 29, 1999).

<sup>73</sup>With respect to taxable businesses, section 162(e)(1)(C) disallows a deduction for amounts paid in connection with attempts to influence the general public with respect to elections or legislative matters. See Treas. Reg. Sec. 1.162-20(c)(4). At the same time, expenditures incurred for advertising which presents views on economic, financial, social, or other subjects of a general nature may be deductible as a trade or business expense, provided that the advertising keeps the taxpayer’s name before the public and is related to the patronage the taxpayer might reasonably expect in the future. See Treas. Reg. Secs. 1.162-20(a)(2) and 1.162-20(c)(5).

<sup>74</sup>See 2 USC 431(8)(A) and 431(9)(A).

<sup>75</sup>See footnote 46 *supra*. If the “express advocacy” standard is constitutionally mandated when no tax subsidy is involved, then the presence of such a subsidy potentially may provide a constitutional basis for moving beyond the “express advocacy” standard and to require disclosure with respect to certain “issue advocacy.” However, under such a “subsidy” rationale, it appears that groups must have the opportunity to engage in conduct that is not eligible for the subsidy—that is, engaging in “issue advocacy” but not disclosing contributors—without incurring a penalty or being unduly restricted beyond the loss of the government tax subsidy. See *Regan v. Taxation With Representation*, 461 U.S. at 553–54 (Blackmun, J., concurring)(denial of section 501(c)(3) status for charities that lobby is constitutionally permissible, because charities may conduct lobbying activities through a controlled section 501(c)(4) entity); *FCC v. League of Women Voters*, 468 U.S. 364 (1984); *American Society of Association Executives v. United States*, 195 F.3d 47 (D.C. Cir. 1999)(organization can avoid burden on its First Amendment rights by splitting itself into two tax-exempt entities, one that refrains from lobbying and receives deductible dues, while the other conducts lobbying but does not receive deductible dues). See also *NAACP v. Alabama*, 357 U.S. 449 (1958)(compelled disclosure has potential to infringe on First Amendment rights of speech and association).

allow tax-free funds to subsidize political campaign intervention. Therefore, the “express advocacy” test is not the appropriate standard for tax code purposes. At the same time, the tax code’s broader facts-and-circumstances approach results in a broad class of entities being eligible for section 527 status as “political organizations,” when only a subset of such organizations currently are subject to FECA disclosure rules.

#### *Disclosure*

The information required to be furnished to the IRS by section 527 organizations under current-law rules generally is adequate for tax administration purposes, given the non-deductibility of contributions to these organizations and the fact that their net investment income is subject to tax. As with other tax-exempt entities that receive similar tax treatment, it may be appropriate to require section 527 organizations, at a minimum, to file with the IRS (and make publicly available) an annual information return.<sup>76</sup>

Under FECA, however, timely periodic disclosure throughout an election cycle and disclosure of contributor identities is essential to effectuating the goals of that statutory scheme. The purpose of the FECA regime is to educate the public and to prevent corruption of the electoral process. The objectives of the FECA disclosure regime are not being accomplished in the case of section 527 organizations which carry out activities that are admittedly intended to influence the electoral process, yet stop short of the “express advocacy” line.

#### CONCLUSION

The Administration supports enhanced disclosure by political organizations as part of its efforts to expeditiously achieve comprehensive campaign finance reform. Just as the current tax code rules do not distinguish between “express advocacy” and “issue advocacy” in the electoral context, so too should the disclosure requirements governing political organizations—under either the Internal Revenue Code or the Federal election laws—not depend on formalistic distinctions between communications that are obviously designed to influence the electoral process.

In recent years, a significant issue has developed, whereby some section 527 political organizations satisfy public disclosure requirements, while other section 527 entities with the admitted primary purpose of influencing elections can side-step disclosure requirements by simply avoiding the use of certain “magic words” in their election advertisements. This is an untenable situation. The important public interest to be served by disclosure is equally applicable to all section 527 entities, regardless of whether they attempt to influence Federal elections through “express advocacy” or “issue advocacy.” As several recently introduced bills demonstrate, there are alternative approaches for achieving consistency in the disclosure obligations of section 527 political organizations. The Administration appreciates efforts made by Members of both parties and looks forward to working with Congress to craft legislation that will provide for enhanced disclosure of political campaign activities.

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Chairman HOUGHTON. Ms. Paull.

#### **STATEMENT OF LINDY PAULL, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION**

Ms. PAULL. Thank you, Mr. Chairman, Members of the Committee. I am pleased to present the testimony of the Joint Committee staff today.

We have prepared a lengthy background pamphlet with whatever data we could assemble for you as well as the present law rules that Mr. Mikrut just summarized, and written testimony which I ask to be submitted for the record. I will simply highlight a few

<sup>76</sup>In its recent study of disclosure by tax-exempt organizations, the staff of the Joint Committee on Taxation recommended that section 527 political organizations be required to file an annual return (regardless of whether they have any taxable income) disclosing information regarding their activities and sources of funds received. See JCS-1-00, Vol. II, at 94-96 (Jan. 28, 2000).

points so that the Committee will have adequate time to ask us questions.

You have heard a lot today about the so-called 527 organizations named after the Tax Code section 527 that governs the tax treatment of political organizations. What is obviously covered by section 527s are what you always think of as a political organization, those are the candidate campaigns, the political parties as well as political action Committees. What is less known about section 527 is that it also refers to segregated accounts that various tax exempt organizations use to make political expenditures. These tax exempt organizations generally are those described in sections 501(c)(4) social welfare organizations; (c)(5), labor and agricultural organizations; and (c)(6), business leagues.

They have a long history of establishing either a related section 527 organization or a segregated account that is treated as a 527 organization. So it is not so easy to separate out from your consideration 501(c)(4)s, (5)s and (6)s from 527 organizations because of this long history of engaging in political activities through related 527s or through a segregated account.

One of the big issues that you will have to face in trying to design disclosure for these organizations is how you segregate out educational activities, lobbying activities, and political activities. There is no bright line test for these various types of activities. As Mr. Mikrut said, the IRS has applied a facts-and-circumstance test, and it certainly depends heavily on the context in which the activity is conducted.

An ad might be educational if it is done on an issue nationwide, and it might have a political angle if it is done and targeted to a specific area where a member may or may not be involved in that issue.

A grassroots effort might be lobbying in one context and political in another or a combination of both. We have highlighted in our testimony a series of private letter rulings the IRS issued over the last 5 years that illustrates the difficulty in trying to delineate between these various activities and easily characterizing them as clearly one or the other. Historically, the line tended to be drawn on the basis of whether or not the activity was partisan or nonpartisan. Organizations got very clever about trying to design things being nonpartisan but having an angle to them based on the issues that they picked to educate somebody on.

The communication, it would matter if the communication was to the member of the organization versus to the general public. You might want to consider how you would categorize that. Also in our written testimony, there is a new breed of 527 organizations that really stem out of the series of rulings that are being created ostensibly to avoid the limits and disclosures of the Federal election law. They take the position that they are not engaged in any express advocacy, that is the advocacy related to a vote for or against, or in support of a particular candidate or vote a party—a set of party candidates. And they get the advantage of the gift tax exclusion for contributions to the organization for their activities.

I would like to summarize a little bit on the disclosure rules. While express advocacy, there is a lot of disclosure about it, the rest of these activities there is a lot less disclosure about it. Under

the tax law the section 527 organizations and the segregated accounts of the tax exempt organizations are not required to disclose their contributors. They are not required to disclose even the dollar amount of their political expenditures. All they disclose is their investment income and expenses on their tax return, and their tax return is not publicly available so they disclose it only to the IRS. They report it only to the IRS.

The tax exempt organizations that I mentioned, the 501(c)(3)s, 501(c)(4)s, and (c)(5)s may be required to file an 1120 POL to report the investment income that is used on political activities, but they generally, as Mr. Mikrut said, would report their political expenditures on form 990, which is open for public inspection and any large contributors over \$5,000 would be reported to the IRS and not subject to public inspection.

I would say that also the amounts reported to the IRS are reported in broad categories, and there is very little description as to what those activities involve. So there could be issue advocacy, there could be lobbying, there could be other political expenditures and there could be education, and there isn't very much description at all as to what those activities are involved with.

There is also the possibility that funds might transfer from one tax exempt organization to another, very difficult to track where the funds are, but those funds could be used ultimately to make political activities, to engage in political activities.

I would note another disconcerting trend is if you were to watch the expenditures, the money raised and the money actually spent by organizations that are involved in some of these activities, you will see their expenditures jump way up in election years, and it is very difficult to track those expenditures because some of them might be laying some groundwater in the early part of the year that culminates in something that looks more like an issue advocacy involving a candidate.

So let me just summarize by saying that there is very little aggregate information reported to the IRS on political expenditures. Very little information about exactly what is going on. It is very difficult to draw the lines between education, lobbying and political activities.

We, again, as a staff, have been working with your staff, and we look forward to continuing to work with you on this difficult issue.

Chairman HOUGHTON. Thank you very much.

[The prepared statement follows:]

#### **Statement of Lindy Paull, Chief of Staff, Joint Committee on Taxation**

##### **INTRODUCTION**

My name is Lindy Paull. As Chief of Staff of the Joint Committee on Taxation ("Joint Committee"), it is my pleasure to present the written testimony of the Joint Committee staff at this hearing before the Subcommittee on Oversight of the House Committee on Ways and Means.<sup>1</sup> Recent press reports have focused on the use of political organizations described in section 527 of the Internal Revenue Code of 1986 ("section 527 organizations") to fund political activities that are not disclosed to the

<sup>1</sup>This testimony may be cited as follows: Joint Committee on Taxation, *Testimony of the Staff of the Joint Committee on Taxation Before the Subcommittee on Oversight of the House Committee on Ways and Means, June 20, 2000* (JCX-60-00), June 20, 2000.



public under either the general Federal tax rules governing disclosure of information by tax-exempt organizations or under the Federal election laws.

At the outset, let me note that the Joint Committee staff in general believes that the public interest would be served by greater disclosure of information relating to tax-exempt organizations. Our recommendations relating to disclosure of information by tax-exempt organizations are contained in our study of disclosure provisions relating to tax-exempt organizations, which was mandated by the Internal Revenue Service Restructuring and Reform Act of 1998.<sup>2</sup>

Our testimony today provides an overview of the present-law rules governing the tax treatment of section 527 political organizations and political activities by tax-exempt organizations in general.<sup>3</sup> In addition, our testimony will describe recent Internal Revenue Service (“IRS”) rulings that have led to the development of a new type of section 527 organization and will discuss how these section 527 organizations are being used.

#### BACKGROUND AND OVERVIEW OF PRESENT LAW

##### *Federal election law*

The Federal Election Campaign Act of 1971 (“FECA”) was enacted to regulate communications made in connection with Federal elections. The FECA, as amended in 1974, 1976, and 1979, imposed restrictions on eligible contributors, imposed dollar limits on contributions, required disclosure of campaign receipts and expenditures, and set up the Federal Election Commission (“FEC”) to administer and enforce the law.

The FECA applies broadly to cover all money spent in connection with or for the purpose of influencing Federal elections. Under the FECA, individuals are permitted to contribute up to \$1,000 to a candidate per election and up to \$20,000 per year in contributions to the federal accounts of a national party committee. In addition to these specific limits, individuals have an aggregate annual Federal contribution limit of \$25,000. Separate contribution limits also apply to multi-candidate political action committees (“PACs”), other political committees, and party committees.

The FECA requires the filing of reports, which are made publicly available. These reports may be required monthly, quarterly, or semi-annually depending upon whether it is an election year and the nature of the reporting organization. Pre- and post-election reports are also generally required. These reports require itemized disclosure of receipts and expenditures in excess of certain dollar thresholds.

Political committees are required to register with the FEC and are subject to the Federal limitations on the amounts and sources of contributions.

In 1976, the Supreme Court ruled, in the landmark case of *Buckley v. Valeo*,<sup>4</sup> that the FECA limitations on contributions were appropriate to guard against the reality or appearance of improper influence stemming from candidates’ dependence on large campaign contributions. However, the Supreme Court overturned the FECA limitations on independent expenditures, on candidate expenditures from personal funds, and on overall campaign expenditures. Thus, the decision in *Buckley v. Valeo* permits unlimited spending by individuals or groups on communications with voters to expressly support or oppose clearly identified Federal candidates, as long as such expenditures are made without coordination or consultation with any candidate.

The *Buckley v. Valeo* court also limited the scope of the FECA to communications that contain express words advocating the election or defeat of a political candidate—so-called “express advocacy.” Thus, express advocacy is subject to the FECA reporting requirements and contribution limits. Communications that fall outside of the FECA definition of “express advocacy” are commonly referred to as “issue advocacy.”

Issue advocacy is a form of “soft money.” Soft money generally refers to money that may indirectly influence Federal elections, but is raised and spent outside of the purview of the FECA. For example, soft money may be spent by state and local political parties on grassroots organizing and voter drives that may benefit all party candidates, not just state or local candidates.

<sup>2</sup>See, Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions As Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998, Volume II: Study of Disclosure Provisions Relating to Tax-Exempt Organizations* (JCS-1-00), January 28, 2000.

<sup>3</sup>The Joint Committee on Taxation staff has also prepared a detailed description of present law for this hearing. See, Joint Committee on Taxation, *Overview of Present-Law Rules and Description of Certain Proposals Relating to Disclosure of Information by Tax-Exempt Organizations With Respect to Political Activities* (JCX-59-00), June 19, 2000.

<sup>4</sup>424 U.S. 1 (1976).

All entities are required under the FECA to disclose allocations of expenditures between Federal accounts (i.e., express advocacy for Federal elections) and non-Federal accounts (including issue advocacy). National parties are required to disclose their sources of contributions and expenditures for both Federal and non-Federal accounts. State and local parties are required to disclose their sources of contributions and expenditures with respect to Federal accounts only under the FECA. Expenditures for issue advocacy by organizations other than national parties are not subject to disclosure under the FECA.

#### *Section 527 organizations*

The Internal Revenue Code provides a limited tax-exempt status to “section 527 political organizations.” Section 527 was enacted in 1975 to clarify the tax treatment of political organizations, such as campaign committees and political party organizations. Prior to 1975, such organizations generally did not pay any Federal income tax. The theory for this treatment was that the contributions made to such organizations were gifts that would not be taxable to the recipient.

In the late 1960’s, the IRS became aware that some political organizations were accumulating significant funds and were not filing tax returns to report their investment income and that funds were being diverted from these organizations for the personal benefit of candidates. In 1968, the IRS ruled that contributions to candidates and political organizations that were diverted from campaign activity were income to the candidate; the IRS required political organizations to keep extensive records to substantiate that there was no diversion of funds. In 1973, the IRS announced that political parties and committees were required to file tax returns unless the Internal Revenue Code was amended. In its announcement, the IRS stated that the gross income of political parties and committees included interest and dividend income, income from commercial activities, and gains from the sale of appreciated property. This announcement formed the basis for section 527.

Under section 527, political organizations are generally exempt from Federal income tax on contributions, but are subject to tax on their net investment income and certain other income. In addition, contributions to section 527 organizations are exempt from Federal gift taxes. A section 527 political organization means a party, committee, association, fund, account, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions and making expenditures for what is called an “exempt function.” An exempt function of a section 527 organization is the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, state, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors.

#### *Other tax-exempt organizations*

It is important to note that other types of tax-exempt organizations may engage in political activities and lobbying activities under present law. Tax-exempt organizations that engage in political activities generally are subject to tax under section 527 on the lesser of their net investment income or their expenditures for political activities. However, such organizations are permitted to establish a separate segregated fund that is treated as a separate organization for purposes of computing the applicable tax under section 527.

Tax-exempt organizations (other than charities described in section 501(c)(3)) generally are permitted to engage in political activities. For most tax-exempt organizations, political activities are inconsistent with the purposes for which the organizations were formed, so the organizations do not engage in any significant amount of such activities. However, certain types of tax-exempt organizations (such as social welfare organizations described in section 501(c)(4), labor organizations described in section 501(c)(5), and business leagues and trade associations described in section 501(c)(6)), do engage in more extensive political and lobbying activities. For these organizations, the only restriction is that the political activities cannot be the primary activities of such organizations. Furthermore, these organizations are not subject to any specific limit on their lobbying activities, as long as the lobbying is germane to the accomplishment of the organization’s tax-exempt purposes. It is not uncommon for social welfare organizations, labor organizations, and business leagues to engage in substantial lobbying activities. According to media and other reports, some of these organizations are also engaged in substantial political activities.

Charitable organizations described in section 501(c)(3) (for example, schools and churches) are not permitted to engage in any political activity under present law. However, such organizations may engage in unlimited educational activities and in limited lobbying activities.

*Educational vs. political or lobbying activities of tax-exempt organizations*

There is no bright-line test under present law for determining when the activities of a tax-exempt organization are political activities, lobbying activities, or educational activities. The IRS has stated that whether an organization is participating or intervening, directly or indirectly, in a political campaign depends upon all of the facts and circumstances of each case. Nonpartisan issue advocacy generally is considered an educational activity under present law. Partisan issue advocacy might be considered a lobbying activity or a political activity under present law. Issues often arise as to the character of activities relating to voter education, such as the dissemination of voter education guides and scorecards. Indeed, the IRS has ruled that not only the format and content of materials, but also the timing and nature of the distribution of materials are relevant in determining whether the materials constitute political activity. Thus, materials that might be considered political activity if disseminated in one manner may be educational in another context.

*Disclosure of information by tax-exempt organizations*

Tax-exempt organizations are required to file an annual information return with the IRS (Form 990). The Form 990 contains information relating to the activities of the organization for a year. The return includes information on the income and expenses of the organization, although these items are generally reported in broad categories. While tax-exempt organizations are currently required to report their expenditures for political activities and lobbying activities on their Form 990s, detailed information about such activities need not be reported.

Under present law, certain public disclosure requirements apply broadly to all tax-exempt organizations. Thus, section 501(c) organizations are required to make a copy of their annual Form 990 available for public inspection. In addition, such returns can be requested from the IRS. However, under present law, section 501(c) organizations are not required to disclose the names of their donors.

Section 527 organizations file an annual income tax return, Form 1120-POL. The return requires such organizations to report certain items of income and expense so that the applicable tax under section 527 may be calculated. The Form 1120-POL does not require any information relating to contributions to and expenditures by the section 527 organization. In addition, the Form 1120-POL is not publicly disclosed under present law.

Section 527 organizations are subject to the FECA rules requiring reporting and disclosure of contributions and expenditures in excess of \$200 if they engage in express advocacy for FECA purposes. However, certain section 527 organizations (such as those organizations that only engage in issue advocacy or that are created solely to influence or attempt to influence state or local elections) may not be subject to the FECA rules.

If a non-section 501(c)(3) organization establishes and maintains a separate segregated fund under section 527, the fund is required to file Form 1120-POL. Form 1120-POL filed for a separate segregated fund (or a separate section 527 organization) is not subject to public disclosure by the organization or the IRS.

## RECENT TRENDS IN SECTION 527 ORGANIZATIONS

Historically, section 527 organizations (other than organizations created to influence state or local elections) were subject to the FECA contribution limits and reporting and disclosure requirements because these organizations were generally created to engage in the type of express advocacy that the FECA regulates.

In addition, many tax-exempt organizations historically argued that the activities in which they engaged were educational activities and not political activities. The recent trend, however, has been to try to characterize certain activities as political, rather than educational. The apparent reason for this shift is the gift tax exemption for contributions to section 527 organizations. Individuals who are willing to make large contributions to fund political activities want the benefit of the gift tax exemption accorded under section 527. Furthermore, as long as the organization has no net taxable income, there will be no tax paid under section 527.

As a result, in recent years, a new breed of section 527 organization has been created for the purpose of engaging in political activity which is apparently not subject to the FECA. These organizations are created to engage in issue advocacy. Many of them are specifically prohibited in their charter from engaging in express advocacy. The genesis of these new section 527 organizations can be traced to a series of IRS private letter rulings beginning in 1996. The rulings highlight the fine line that the IRS has drawn between permitted educational activities (nonpartisan issue advocacy) and political activities for section 527 purposes.

In these rulings, the first of which was issued in 1996, the IRS ruled that voter education and grass roots lobbying that tax-exempt organizations had contended for many years were educational activities could be characterized as political activities for section 527 purposes. In the first ruling, in 1996, the IRS stated that the purpose of a fund (section 527 segregated fund) maintained by a section 501(c)(4) organization was “equivalent to accepting and expending funds not (emphasis added) to expressly advocate for or against candidates, but to promote a program of issue advocacy designed to influence the public to give more importance to \* \* \* [certain] issues when they decide among the candidates.”<sup>5</sup> The apparent reason for requesting the IRS ruling was to ensure that a large individual contributor would be accorded the exemption from gift tax for contributions to section 527 organizations.

In the 1996 ruling, the section 527 fund was used to finance issue advertisements and the distribution of voter guides on candidate records. The fund’s activities were limited to the preparation, publicizing, and distribution of Congressional voting records and voter guides on Federal elected officials and candidates. According to the ruling, the voter education materials paid for by the fund would include some or all of the following: (1) comparative information about the identities and amounts of campaign contributions received by the candidates; (2) comparisons of incumbents’ voting records with their challengers’ views on the same subjects; (3) information about the past and current affiliations of the candidates with certain issues or groups; (4) quotations from statements by opposing candidates on the same issues; (5) voter guides listing all Federal candidates throughout the country; (6) voter guides listing only the major party candidates for Federal office; (7) voter guides limited to the Federal candidates in a single state or district; (8) voter guides comparing the candidates on only one issue, or on many issues; (9) voter guides formatted to fit the special characteristics of television, radio, newspaper, on-line, or other media; (10) voting records on certain issues; (11) materials containing messages suggesting that voters should study the candidates’ records on certain issues carefully, or that one should remember to vote on Election Day; and (12) dissemination of voting records and voter guides using television, radio, newspaper, newsletter, magazines, and other print media, on-line electronic transmission, mail, telephone banks, facsimile transmission, posting of signs, public meetings, rallies, media events, door to door canvassing, and other forms of direct contact with the public.

In 1997, the IRS issued another private letter ruling on similar facts. In this case, a social welfare organization described in section 501(c)(4) was developing an election-year voter education program to raise public consciousness about the importance of certain issues and about the positions of incumbent public officials and candidates on those issues, “without engaging in express advocacy for or against any identified candidates.”<sup>6</sup> The organization intended to engage in the dissemination of voter education materials (similar to the facts in the 1996 ruling) and grass roots lobbying. With respect to grass roots lobbying, three potential types of activities would be conducted: (1) a grass roots lobbying handout would be used in door to door canvassing, targeted to congressional districts and locations within states selected with the political interests of the organization in mind; (2) mass media advertisements would be prepared, timed to be disseminated during a major political party convention, listing the legislative proposals introduced in the current Congress and urging the public to call and ask Congress to act without mentioning a specific bill; and (3) mass media advertisements would be targeted to certain congressional districts or states where the organization has a political interest and would refer to one or two incumbent legislators from that district or state, by name, indicated one or more votes they cast or positions they took in Congress on issues of importance to the organization.

The IRS ruling noted that the grass roots lobbying in this case reflected a dual character by calling for legislative action, and also raising public awareness about how the identified legislators stand on issues that the organization believes voters, based on opinion polling, would take into account in making judgments about the positions of the candidates. The IRS also stated that all of the grass roots lobbying activities described by the organization would have a political purpose even though they would not expressly advocate the election or defeat of any particular candidate.

In 1999, the IRS addressed the issue of an organization that was organized to engage both in express advocacy and in partisan issue advocacy.<sup>7</sup> Specifically, the organization intended to make contributions to the campaigns of certain candidates, pay for political advertising expressly advocating the election or defeat of named

<sup>5</sup> PLR 9652026.

<sup>6</sup> PLR 9725036.

<sup>7</sup> PLR 199925051.

candidates, mass media campaigns, ballot initiative campaigns, and litigation strategically aimed at altering the political process. The organization represented that the main part of its activities would involve issue advocacy. According to the ruling, the organization would develop and distribute voter guides and voting records, mass media advertisements, grass roots lobbying, direct mail campaigns, and the active use of ballot measures, referenda, initiatives, and other public opinion campaigns, all linked to the primary purpose of influencing the political process. These activities would occur over several election cycles.

In the 1999 ruling, the organization indicated to the IRS that issues would be selected based on a combination of legislative priorities of the organization, the organization's general public policy agenda, and public opinion research. The issues selected would encourage differentiation between candidates whose views on selected issues agree with the organization and those opposed to such views. Distribution of materials and the scheduling of events would be targeted toward areas of the states in which the organization had a political interest and in which it believed it could have a political impact.

With respect to the voter registration and get-out-the-vote activities of the organization, the IRS ruled that such activities were partisan. The IRS noted that, while the activities were not specifically identified with one candidate or party in every case, they were partisan in the sense that the organization intended these measures to increase the election prospects for candidates with stands favorable to the organization. Thus, the IRS concluded that expenditures for these activities qualified under section 527.

The IRS ruling stated that generally, expenditures made in connection with ballot measures, referenda, or initiatives are not section 527 activities. However, the IRS stated that expenditures for such activities could qualify under section 527 if it can be demonstrated that such expenditures were part of a deliberate and integrated political campaign strategy to influence the election of certain candidates. The IRS further noted that the organization had indicated that its participation in such campaigns was for the purpose of linking candidates, in the minds of voters, to positions on certain issues within the organization's area of interest and encouraging voters to give greater weight to these issues when making judgments about candidates.

#### MEASURING THE AMOUNT OF ISSUE ADVOCACY BY TAX-EXEMPT ORGANIZATIONS

These rulings highlight some of the ways in which section 527 organizations are being used to engage in activities that may not be subject to the FECA. However, it is difficult to measure the extent to which these organizations are being used for this purpose and the growth in the number and size of such organizations.

Information available from the IRS Statistics of Income indicates that the number of Form 1120-POLs filed grew from 1996 to 1998. In 1996, 4,363 returns were filed for the period from December 1994 through November 1995; in 1997, 6,006 returns were filed for the period from December 1995 through November 1996, and in 1998, 5,649 returns were filed for the period from December 1996 through November 1997. The number of Form 1120-POLs filed during the period were the highest during the 1996 election cycle. Data for the 1999 filing year are not yet available.

Total political expenditures reported for non-section 501(c)(3) organizations on either the Form 990 or Form 1120-POL for 1994 were approximately \$38 million and for 1995 were approximately \$29 million. Aggregate data for more recent years are not available.

Based on an informal survey of Form 990 information filed by tax-exempt organizations, political expenditures appear to increase significantly during election years relative to other years for organizations that engage in this type of activity. Thus, while it is not possible to assess fully the extent to which tax-exempt organizations are attempting to influence the political process, it is clear that such organizations are engaged in activities intended to influence, directly and indirectly, campaigns at the Federal, state, and local level.

We should also note that the extent of tax-exempt organization activity intended to influence the political process cannot be measured accurately merely by looking at the political expenditures reported by such organizations on their Form 990s. Tax-exempt organizations may also engage in lobbying activities that are intended to influence elections. In addition, many tax-exempt organizations will take the position on their Form 990s that the activities in which they are engaged are educational, rather than political. As a practical matter, the IRS and the general public will not be able to discern from the Form 990 the exact nature of activities that are characterized as educational because such activities are reported in broad and general terms. Thus, the only way in which such activities may be challenged under present law is through an IRS audit of the return of a tax-exempt organization.

Some organizations have attempted to quantify the extent to which section 527 organizations are engaged in partisan issue advocacy. One group estimated that approximately \$100 million has already been spent or committed for issues advertisements on a variety of issues during the 1999–2000 election cycle.<sup>8</sup>

The Annenberg Public Policy Center of the University of Pennsylvania has identified 37 organizations that funded, or committed to fund, broadcast media issue advertisements between January 1999 and early March 2000 costing in excess of \$114 million.<sup>9</sup> The Annenberg Center estimated that this amount was nearly as much as was spent on issue advertising in the entire 1995–1996 election cycle.

The Annenberg Center also provided information on the types of issues advertisements that had been run by various organizations.

One example cited in the Annenberg Center materials was a series of television advertisements run in May 1997 as the Senate was preparing to vote on the late term abortion ban. The ads urged citizens to call their Senators and aired in the states of undecided senators. A repackaged version of the ads were run in 1998 against a candidate in a Congressional special election. The Annenberg Center noted that the ads, which were aired as nonpartisan issue advocacy ads in 1997, were aired as direct advocacy independent expenditures in 1998.

In another example cited by the Annenberg Center, an organization aired television advertisements on taxes and health care in two states with important Senate and House races in 1998. The ads advocated against the policy positions of incumbent Senators running for reelection and also targeted an incumbent House member in one race. In one television ad that described the positions of a challenger to one of the incumbent Senators, the announcer stated:

• “Candidate X knows that nothing is more important than our health. That’s why Candidate X voted to guarantee health insurance for people who change or lose their job. And Candidate X voted to require insurance companies to cover people with pre-existing medical conditions. To help women fight breast cancer, Candidate X voted to expand insurance coverage for mammography testing for women over fort. Good healthcare is important. Call. Tell Candidate X you support his efforts to improve health care.”

Although the Annenberg Center materials do not identify whether section 527 organizations or other organizations are creating the types of issue advertisements cited in the materials, there is a clear trend toward greater use of section 527 and tax-exempt organizations in general to engage in partisan issue advocacy. The present-law disclosure rules for tax-exempt organizations do not require organizations to disclose the same type of information that is required under the Federal election laws. Unless present law is changed, it will be difficult for the public to assess the extent to which tax-exempt organizations are engaged in political activities.

[An attachment is being retained in the Committee files.]

Chairman HOUGHTON. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

I would like to ask this of either one of the panelists or both. Several of the members have suggested that once the secrecy of the 527s may be shut down or eliminated, but that will only shift similar activities to other tax-exempt organizations. I was just wondering, do you have anything to propose that we can guard against that eventuality?

Ms. PAULL. Since some of these activities are already ongoing in some of these organizations, some sort of encouragement for them to disclose their activities, if you are going to go after the 527s to disclose their activities, would be useful as a start.

Mr. COYNE. What kind of disclosure? What would you recommend as an item of disclosure from the other tax exempts?

<sup>8</sup> Common Cause, *Under the Radar: The Attack of the “Stealth PACs” on Our Nation’s Elections, A Report From Common Cause*.

<sup>9</sup> Issue Ads @APPC. “<http://appcpenn.org/issueads/2000issuead.html>”><http://appcpenn.org/issueads/2000issuead.html>.

Ms. PAULL. The type of disclosures that some members have suggested that once you cross over some sort of threshold for the year, you might want to begin disclosing your expenditures that come—there is no bright line test as to what is education lobbying and political, but you might want to consider applying, after you've crossed over some sort of threshold, applying the same kind of rules that you would apply to the 527.

Mr. MIKRUT. Mr. Coyne, it is very easy to apply disclosure rules to the 527 organizations because they come forward and claim that they are engaging in political activity. So there is no question what they are doing. When you look at 501(c)(4)s, (5)s and (6)s, the Code prohibits them from primarily engaging in those political activities, so there is a question as to what extent are they engaging in such activities. If you wanted to provide disclosure in those areas, I think it would be very important to have a very objective standard as to what "political activity" would be. The standard that the Service uses currently under the Code with respect to 527s is essentially that of attempting to influence an election. That is a somewhat subjective standard and may be difficult to apply to a 501(c)(4), (5) or (6).

If there was something that was more objective that actually looked to their activities or looked to the timing of their activities, I think that would be easier for the Service to administer. In addition, if the disclosures that you want relate not only to the expenditures of these organizations but also to their contributors, it may be difficult to tie any one expenditure to a contributor, unless the amounts are earmarked for a fund or go to a specific fund that are used for these electioneering activities.

So in summary, it is very easy to design a disclosure regime for 527 organizations so they will disclose their political activities. It is more difficult and creates more line drawing with respect to organizations that do other things besides political activity.

Ms. PAULL. May I insert one more comment. With respect to contributors, I think this is where the difficulty is. As I mentioned, there is a significant amount of activity right now of 501(c)(4), 501(c)(5)s and (6)s, either in a related 527 or in a segregated account that is treated as a 527, and the transfer of money from one of those organizations to the segregated account in the 527, you might be able to report it, but you will not know the ultimate source of that money unless you go behind the contributions to the organization in some way. I just point that out. That seems to be something that is missing out of some of the legislation that has currently been proposed.

Chairman HOUGHTON. Thank you.

Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman and thanks to our panelists. It is interesting the testimony of the preceding panel and the sentiment this afternoon kind of reminds me of a game that we see at the arcade with kids—whack a mole—where you hit one of the little moles that comes out, bam, you hit him, and it gives you a couple of points electronically, and then another one pops up.

And it seems part of what we are doing really even transcends the effort by my friend from Texas with reference to 527s. For example, I am sure that the People's Liberation Army of the Com-

munist Chinese is not registered as a 527, that actions taken in the 1996 campaign were already clearly illegal. And so it is interesting to hear that the most egregious form of campaign abuse is with the 527 Committees, and note for the record, Mr. Chairman, and all of my colleagues in a bipartisan and candid fashion, the greatest abuse of campaign finance came with the willful injection of Chinese Communist money into the 1996 campaign, and far from the roar of the grease paint and the smell of the crowd and the popular sentiment of the mainstream press, and despite the best efforts of some on this Committee to do their fairly inspired productions of Lady Macbeth, with reference to 527s, I would submit that now and forever that legacy of shame will not be eliminated by any action taken on 527s.

But to the legislation at hand, Mr. Mikrut, the IRS Restructuring and Reform Act of 1998, the RRA directed the Department of Treasury to complete a study on the political activities of tax-exempt organizations, didn't it?

Mr. MIKRUT. Yes.

Mr. HAYWORTH. When was that report to have been completed per the RRA?

Mr. MIKRUT. Earlier this year, Mr. Hayworth.

Mr. HAYWORTH. What was the specific date?

Mr. MIKRUT. January 22nd.

Mr. HAYWORTH. Has the Treasury Department completed this study?

Mr. MIKRUT. We have not. The last time I was before the Committee, I think, responding to a question from Mr. Thomas, I indicated we were hard at work on the study and we hoped to get it out at the end of June, and we are still on that schedule.

Mr. HAYWORTH. The fact that we are going to bring a bill to the floor, you are telling us today that the report will be here by the end of June coinciding with the time that we plan to bring a bill to the floor?

Mr. MIKRUT. That is the schedule that we are still trying to complete it by, Mr. Hayworth.

Mr. HAYWORTH. We appreciate the commitment.

I hope you can give us an idea of Treasury's preliminary findings in the report. What, in general, have you found?

Mr. MIKRUT. I think most of the discussion that I can share with you today is contained in my written statement and my oral statement, Mr. Hayworth. We do agree with some of the things that the Joint Committee staff has proposed. For instance, with respect to 527 organizations, they have proposed, and we concur that there is very little information reporting. These entities generally file a form 990 POL, which simply reports the tax on their investment income and they do not file a form 990 in general. Perhaps that is something that should be examined.

Mr. HAYWORTH. Does Treasury believe that other tax exempt organizations, namely section 501(c)(4) and (c)(5) and (c)(6) organizations should be treated differently with respect to disclosure of substantial expenditures for the same types of political activities, and why or why not?

Mr. MIKRUT. Differently from what?

Mr. HAYWORTH. Differently from the 527s.



Mr. MIKRUT. I think we believe that more disclosure with respect to these activities, no matter whether conducted by a 501(c)(4), (c)(5) or (c)(6) or 527 is good policy.

We would point out that with respect to a 527, as I mentioned earlier to Mr. Coyne, that it is very easy to craft rules to provide for disclosure, because these are organizations that come forward and volunteer the fact that they are political in nature and their activities are political. That is not necessarily true for 501(c)(4)s, (5)s or (6)s, whose primary goal must be something else, otherwise they would lose their status as such.

Mr. HAYWORTH. But you said it would be good to have disclosure from the 501(c)(4), 501(c)(5)s and (c)(6)s?

Mr. MIKRUT. In trying to craft the rules, the rules may have to be different in order to recognize the different nature of those types of entities.

Mr. HAYWORTH. Mr. Chairman, I think one of our challenges is not the perfect being the enemy of the good, but the interesting definition of bipartisanship in Washington, D.C. which always seems to mandate that the majority must twist and bend its will to the whims of the minority, or else there is a poison pill, and nothing can be done. I thank you.

Chairman HOUGHTON. Mr. McNulty.

Mr. MCNULTY. I will pass at this time, Mr. Chairman.

Chairman HOUGHTON. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman. First of all, thank you for letting me sit on the Oversight panel. Having been on this Subcommittee in the past, we only have so many choices available and it is nice to be back. In my other life, I am chairman of House Administration, which oversees all of the Federal election campaign laws, and this issue of groups that participate, although clearly from a fundamental first amendment right participation, the courts have defined it as very explicitly advocating the election or defeat of someone, I think one of the frustrations that has developed over the years is that there are people who can participate in a relatively expensive and meaningful way in the process to influence the outcome of an election without ever crossing that clear constitutional free speech line that the Supreme Court has established.

And so my question is that I recall in previous hearings from people who were concerned about this, Common Cause, a number of other groups, that it used to be the 501(c)(3)s in terms of some of the educational activity which clearly never violated the constitutional line of express advocacy of defeat or election, but participated in "educational ways."

Mr. Mikrut, what I would be curious to know is does the Treasury have any information about the evolution of some of these entities? That is, did some of them start in the 501(c)(3) category that this bill tends to look at? And did they migrate to 527s because it was a more insulated and protective world? Are there 501(c)(4)s, (5)s and (6)s that don't participate in 527 world? And are 501(c)(4)s, 501(c)(5)s, and (6)s who have created 527s?

Do we have a chronological or evolutionary feel for what has occurred because as you well know, even 5 years ago, nobody used the term 527. Now it is the embodiment of all concerned, dis-

regarding some of the more traditional ones that historically were seen as fudging the line in terms of if not a constitutional participation in the election, clearly a realistic and physical one.

Mr. MIKRUT. Mr. Thomas, I think there is an explanation by those who have looked at this and some of the panelists coming up have looked at this on a historical basis. When 527 was first enacted in 1974, there was an implicit assumption that both their issue advocacy and their express advocacy were subject to FEC disclosures. I think the subsequent *Buckley v. Valeo* and lower court interpretations of those standards applicable to their first amendment protections have somewhat limited, I think, to the view of some, the extent to which issue advocacy is disclosable under the FEC rules.

Mr. THOMAS. Clearly the ball is moving and it is a dynamic world. If, in fact, you just deal with 527s, is there any information about the 501(c)(3)'s involvement with 527s that we wouldn't pick up the dynamic of assistance in movement there that, in fact, would give us a fuller picture if we looked at the 501(c)(3)s as well?

Mr. MIKRUT. I think that is clear, Mr. Thomas, if you simply legislated in one area, such as 527s. As you mentioned, it is a dynamic process. Doing that may effect a change and there may be other activities in 501(c)s.

Mr. THOMAS. I am glad you mentioned that. If we are going to try to trace the chain of people who are trying to maximize their ability to influence the system, if you just disclose 527s, I think you would agree we might see significant shift in a change in participation in the 501(c)(3)s. I think that is one of the reasons that the Chairman is anticipating those moves, and therefore making sure that they don't happen.

But isn't it also true if we, in fact, did what this bill does, and I think we should, that there is ultimately a refuge from which it may be difficult to get these folks, and that is, they can simply create a for-profit structure in which their goal may not necessarily be to make a profit, but to, in fact, influence the political system through advertising and other areas? So for people who are looking for a magic bullet to stop this, I really want to create an understanding here that what we are trying to do is make sure that people don't take advantage of the Tax Code to not only involve themselves, but to get a tax break in doing it, but that if you are trying to legislate behavior, are you not going to be successful. We are trying to make sure that these categories are used for the purposes they were intended to be used for, and not to stop this kind of participation in the political process because you can create a for-profit structure and carry on the same activity. I thank the Chairman.

Chairman HOUGHTON. Thank you.

Mr. Doggett.

Mr. DOGGETT. Thank you. Ms. Paull, back in January, I believe, the Joint Committee Staff first made its recommendation that additional disclosures from 527 organizations should be made.

Ms. PAULL. That's correct, Mr. Doggett.

Mr. DOGGETT. And those disclosures are somewhat different than those incorporated in my bill. You continue to feel because of their unique nature, we need additional disclosures from 527 organizations?

Ms. PAULL. That's correct, Mr. Doggett.

Mr. DOGGETT. I know in that report on page 95, I believe the one outside source out of the Committee staff to which you referred was the writing of Dr. Frances R. Hill?

Ms. PAULL. Yes, we have.

Mr. DOGGETT. And she is one of the leading experts on 527s and nonprofits in the country?

Ms. PAULL. She has done a lot of work in this area, yes.

Mr. DOGGETT. You heard Senator McCain's testimony. Is there anything in your findings or the work of the Joint Committee Staff that conflicts with Senator McCain's testimony as you heard it?

Ms. PAULL. I think Senator McCain was taking a pragmatic approach if I heard it correctly, and—

Mr. DOGGETT. I agree with that.

Ms. PAULL. —trying to be carefully with how far the legislation went.

On page 80 of our pamphlet, you might see the numbers for the most recent years we had available, which was not that recent because we think that there is lot more activity going on since 1995, that there were at least a thousand 501(c)(3), (4), (5), the way that this was categorized by the IRS also swept in some other organizations, but we don't believe that they are involved in this activity, at least 1,000 of those organizations who were involved in political activities.

Mr. DOGGETT. So you basically believe that your findings and testimony is consistent with Senator McCain's?

Ms. PAULL. I think I would go a little further than Senator McCain and make sure that the same kind of disclosure that you would be asking for for 527s would be done by (c)(4)s, (5)s and (6)s in a meaningful way. I think I also noted that it is difficult to draw the lines here.

Mr. DOGGETT. Mr. Mikrut, while I always wish the Treasury Department would produce its report sooner, this has been an issue with some other subjects that I am interested in. Isn't it correct that how to deal with 527s, that is not the principal focus of the Treasury report, and at best, any report from the Treasury will be marginally relevant to anything we do here in Congress with respect to 527s.

Mr. MIKRUT. We are working and looking at, and the mandate was with respect to, all of sections 6103 and 6104, which deal with disclosures with respect to all tax-exempt entities, not just their political activities.

Mr. DOGGETT. And as far as the comment made by our colleague earlier about the Chinese Liberation Army, there is really, under our existing laws, no way to tell whether this attack from RMIC on Mr. Forbes was financed entirely by Chinese money, is there?

Ms. PAULL. I don't think we have any way of knowing the source of the funding.

Mr. DOGGETT. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I want to commend you for taking on the herculean task in a highly charged political year of dealing with this very important issue. All of us want to

see more disclosure, and all of us want to see the ability to understand sources of funding, and all of us would like to see this resolved, but it is a challenge because we have a murky situation at best with regard to the various kinds of nonprofits that can engage in political activity, and again, in a political year, it is difficult to weave our way through the maze. So I want to thank you for undertaking this task, and I am supporting you in it.

Let me ask the witnesses a few questions to get a better handle on the distinctions between 527s and the 501(c)(3), 501(c)(4)s, 501(c)(5)s. This is an issue that we have talked about on the floor. Usually it has been a pretty partisan conversation. If we can stick to the facts in our questions and answers, I think it would be very helpful.

First of all, this would be either to you, Mr. Mikrut, or to you, Ms. Paull, and perhaps you can have a consensus answer that is yes or no.

First of all, can a 501(c)(4), which is social welfare organization in the Code, place an ad on television or in a newspaper or magazine or radio that specifically endorses or opposes a Federal candidate without losing its tax-exempt status?

Ms. PAULL. Yes.

Mr. MIKRUT. Yes.

Mr. PORTMAN. Will that expenditure be taxed?

Mr. MIKRUT. To the extent of investment income.

Mr. PORTMAN. The expenditures for that particular ad would be taxed.

Must an organization disclose its expenditures for this ad that it did on television or radio to the FEC?

Ms. PAULL. It depends on the ad. I am sorry—.

Mr. PORTMAN. The situation specifically endorsing or opposing a Federal candidate?

Ms. PAULL. Yes.

Mr. PORTMAN. Let me change the facts. Suppose the same organization, and let's call it Americans for Better Weather, like we are having here in Washington today, places an ad in an election year, and in this case, the ad says candidate A has consistently voted for a bill to promote better weather in America. Candidate B is not discussed. The ad says candidate A has subsequently voted for bills that promote better weather, so please call his office and thank him for voting for bills that promote better weather. This ad never expressly endorses candidate A or mentions candidate B. Will that expenditure for the ad be taxed?

Mr. MIKRUT. I believe that is within 527, and therefore subject to 527, and would be subject to tax to the extent of investment income.

Ms. PAULL. I agree.

Mr. PORTMAN. Let me give you the facts again a little more slowly. This is an ad which says candidate A has voted legislation which promotes better weather. The ad does not advocate election or defeat of that candidate, and does not talk about his opponent. My question to you is would this expenditure for this ad be taxed?

Mr. MIKRUT. Again, Mr. Portman, what the IRS tries to apply is a facts-and-circumstances test. When you look at the ad in the context of an election, is there a nexus between the ad and trying to

influence an election? Perhaps not directly, but the Service looks at it as a total facts-and-circumstances test, and under that type of standard, it is likely that such an ad may be subject to tax, yes.

Mr. PORTMAN. It is likely that it may be subject to tax. What do you think?

Ms. PAULL. I agree.

Mr. PORTMAN. Wouldn't some organizations, wouldn't most organizations claim that such an ad is educational and therefore not a taxable expenditure? It is educational. It is saying candidate A has voted to promote better weather legislation.

Ms. PAULL. As I said in my testimony, you have to determine the whole context here. Is this—have you decided that you are not running for reelection and people—

Mr. PORTMAN. No, I said it was candidate A.

Ms. PAULL. Taken in the whole context of the election atmosphere, it could well be a taxable event and it may not be.

Mr. PORTMAN. It could be, but it may not be.

I think the answer to the question from what I can tell, from looking at the cases and from trying to read up on this in the context of this hearing, is that almost every organization in America that does this kind of stuff would say no, it is not. It is an educational effort. We are not expressly pushing for the defeat or election of a candidate, we are doing an education ad. My next question is, if that is true and maybe Mr. Mikrut, you disagree.

Mr. MIKRUT. I think the organizations may take a different position than the IRS, yes.

Mr. PORTMAN. Depending on the facts and circumstances, but this is not saying elect them or don't elect them. If the organization feels it is educational, do they have to disclose the expenditures of the ad to the FEC?

Mr. MIKRUT. To the FEC, this—

Ms. PAULL. It wouldn't matter.

Mr. PORTMAN. They would not have to disclose?

Ms. PAULL. It is not express advocacy.

Mr. PORTMAN. So you wouldn't have to disclose.

Let me put it this way. Do you believe that this type of ad would be reported on a political expenditure on the organization's form 990?

Mr. MIKRUT. Yes, I think it would be disclosed as a political expenditure.

Mr. PORTMAN. Why is it a political expenditure if it is not express advocacy, if it is an educational effort?

Mr. MIKRUT. Because it may include *both* issue advocacy.

Mr. PORTMAN. I think that is very murky. That is a gray area because if it is not political advocacy, not express advocacy, I don't think that it has to be reported. My point here is there is a lot of gray area here. There is a shaking of a head behind you. Would it have to be reported?

Ms. PAULL. It would be reported either as education or political expenditure. If, as I think generally are on-balance view is that it is a political expenditure, it would be reported on the line of political expenditures in an aggregate amount.

Mr. PORTMAN. Let us assume that it is reported as educational because I think that is where most organizations are going to put it. Where is it reported on the 990?

Ms. PAULL. Program expenses.

Mr. PORTMAN. Program service activities. In other words, it would be hidden?

Mr. MIKRUT. Yes.

Ms. PAULL. Political expenditures also are in the aggregate. They are not described in any detail.

Mr. PORTMAN. OK. I would just say would you have the same responses to my questions if the organization were a 501(c)(3)?

Ms. PAULL. Sure.

Mr. MIKRUT. Yes.

Mr. PORTMAN. And (c)(6)?

Ms. PAULL. Yes.

Mr. PORTMAN. My point is a 501(c)(4), a 501(c)(5), and (6) can do a lot of activities that a 527 can do. There is a lot of need for definition and there is potentially room for abuse. There is a lot of disagreement between where the IRS may come out and where most organizations seem to be coming out, and I think that is a very important point to be made. We need to look at the broad range. We push something down in one area of campaign finance laws, and they pop up somewhere else. Even though there is currently some disagreement and gray area, there is likely to be more. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much. I would just like to ask a quick question, and I guess it follows on the heels of this. You probably are aware of the bills by Senator Snowe and Jeffords and some of the things that Mr. Shays has advocated vis-a-vis broadcasting.

Are those going to get at some of the abuses that we are talking about here?

Ms. PAULL. Mr. Houghton, I think they certainly would address a narrow category of communications. As you said, they are broadcast ads and they are timeframes before the election for which they would be hit.

The problem is that these organizations have gotten very creative and what they do, they would first start—the information that we have gotten, for example, is they first start with an issue, and you advertise on that. Then you might follow it up with what Mr. Portman just said. You have raised this issue in the public's mind. Then the next ad might be this particular candidate is good on the issue. Call him and thank him.

Then the next ad might be this particular candidate is good on a vote for them in the end, and it is a whole series of ads, some of which start out very innocuous, but there is a whole program going on from the beginning to end to achieve that kind of a purpose.

The same thing could occur to attempt to defeat a candidate. All of those taken together are intended to influence the outcome of an election. And so if you just set some arbitrary time period before an election and say the only things we are going to count will require to be disclosed, you are going to miss a lot of activity, I think.

Mr. THOMAS. Mr. Chairman?

Chairman HOUGHTON. Mr. Thomas.

Mr. THOMAS. Could I briefly review with you what you could or couldn't do under Jeffords-Snowe if we are trying to get at certain activities?

Chairman HOUGHTON. Sure.

Mr. THOMAS. If the broadcast communication is to the public and it mentions a Federal candidate made within 60 days of the general election, or 30 days of the primary election, yes. Both in 527, 501(c)(4)s for lobbying organizations and (c)(5)s for unions and (c)(6)s for trade associations, they all get impacted by that. But listen to what Snowe-Jeffords doesn't cover: Broadcast communications to the public that mention Federal candidate made 31 days before a primary or 61 days before a general election; broadcast communications to the public that mention a political party but not a clearly identified Federal candidate; direct mail communications to the public that mention a Federal candidate; mass telephone bank communications to the public that mention a Federal candidate; paid precinct worker campaign distributing literature to the public that mentions a Federal candidate; billboards outside advertising that mentions a Federal candidate.

I have got another 15 categories of direct political participation that Snowe-Jeffords wouldn't cover. The point being, it is a specific timeframe in a specific window when there is a world of activity out there, none of which would be covered. Thank you.

Ms. PAULL. Mr. Chairman, if you were going to pick a timeframe, you certainly would pick the election years because we have been going back and doing some spot-checking, and you can really see the expenditures pop up in an election year. You can see them being five times what they were the year before in a cycle. If you need to pick a timeframe, I certainly would pick those election years as the entire year.

Chairman HOUGHTON. Mr. Mikrut?

Mr. MIKRUT. An approach like Snowe-Jeffords will avoid some of the problems that Mr. Portman has raised, that if the standard, which is under current law 527, is to influence election, reasonable people could disagree as to what that standard is. However, if you have a more objective standard as to an ad run on a certain medium, or within a certain timeframe, whatever that timeframe may be, that is much more objective, and you would know whether you were subject to the rule or not subject to the rule. This would avoid some of the problems that Mr. Portman has pointed out.

Chairman HOUGHTON. Thank you very much, both of you. It is very, very helpful.

We have another panel. Mr. Glen Moramarco is attorney for the Brennan Center for Justice in New York, the University School of Law, New York; Larry Makinson, executive director, Center for Responsive Politics; and Frances Hill, professor, School of Law, University of Miami; and Leo Troy, professor department of economics, Rutgers University; Cleta Mitchell, attorney, Sullivan & Mitchell; and Hon. Trevor Potter, senior fellow, Brookings Institution and partner, Wiley, Rein & Fielding, former commissioner, former chairman, Federal Election Commission.

Mr. Moramarco, would you start your testimony.

**STATEMENT OF GLENN J. MORAMARCO, SENIOR ATTORNEY,  
BRENNAN CENTER FOR JUSTICE, NEW YORK UNIVERSITY  
SCHOOL OF LAW**

Mr. MORAMARCO. Thank you, Mr. Chairman. I am Glenn Moramarco, I am a senior attorney at the Brennan Center for Justice, New York University School of Law. I am happy to be invited to testify before the Committee on this important issue. In my few minutes before the Committee, I would like to make three specific points: One, I think that 527s are unique and should be given special and different treatment.

The second point is when you go beyond 527 organizations, I believe that you should not make your legislation turn on what section of the Tax Code is being affected, but look at the activities of the organization. And third, I would like to talk about a study that the Brennan Center conducted called "Buying Time" that I would ask to put in the record at the conclusion of my remarks that looked at all of the ads that are placed in the 1998 Federal Congressional Elections and the facts about disclosure that we learned from that study.

Let me begin with the 527 organizations which seem to be the heart of the discussion.

And I understand, Representative Coyne asked questions to Senator Lieberman earlier about what interplay is there between 527s and political Committees, and it is interesting because whenever I read about 527 organizations, it always starts with the same sentence, that until recently, everyone always assumed that 527 organizations were political Committees subject to FECA, and I want to suggest to the Committee there was a good reason for that assumption.

It is because they are subject to FECA and should be. The definitions are nearly identical, and it is a myth and a fiction that these organizations are not, in fact, political Committees. What seems to be the case is that we do not have four votes on the FEC now to enforce currently existing law, we have to deal with that as a practical matter, but it is important to recognize, because really, Congress's initial will in drafting these two provisions to have identical language is being frustrated.

The reason that I mention that is any suggestion that 527 organizations can't be held to the same—to full and fair disclosure requirements I think is a fundamental misreading of Buckley. When the Supreme Court in Buckley talked about having things limited to express advocacy, the court was very specific that it was not talking about political candidates, it was not talking about political parties, and it was not talking about political Committees. It adopted the narrowing interpretation of FECA, because there were actors outside of these core groups, groups like Right to Life, the pro and antiabortion groups, and all sorts of issue advocacy speakers that needed special protection. But for the core groups, there is no question that what they are doing is subject to regulation.

Now, what I would suggest is that when you move beyond section 527 organizations, you get into more potential constitutional problems. Chairman Houghton, you received a letter from 15 of your colleagues supporting the Snowe-Jeffords approach, I would urge you to give serious consideration to that. There was a lot of



support for it on the initial panel as well. What the Snowe-Jeffords approach is trying to do is meet Buckley's concerns and provide some certainty. It may not cover everything, but it looks at the conduct so you won't be chasing these groups around different portions of the Tax Code, whether they are in (c)(4) or (c)(5) today or 527 tomorrow, you look at what they are doing; are they naming candidates in a specific timeframe on particular medium, and you can increase the medium.

There is nothing magic about Snowe-Jeffords' choice about broadcast and radio. If you want to add direct mail, if you want to add phone banks you can do that, but you need certainty. That is what the Supreme Court was telling us in Buckley, and this gets away from all of the problems that I was hearing from some of the members suggesting that groups are not being treated the same. It should not matter where they are in the Tax Code. Look to their actions and that is what Snowe-Jeffords does.

On the third point, we had a blue ribbon panel that included a number of your former colleagues. They looked at all of the ads in the 1998 campaign, and we found that just 4 percent of even the candidate ads used magic words of advocacy. So that is why Snowe-Jeffords tries to go beyond that to look at a more reasonable definition of electioneering.

What we found was that the definition in Snowe-Jeffords, McCain-Feingold seems to be tracking with pretty good accuracy the distinction between true issue ads and electioneering ads. We call for three solutions, or the policy Committee called for three solutions there. They wanted the ads to have more prominent disclaimers. Right now, 25 percent of the ads didn't have disclaimers that were required. We think that there should be a standard form and repository for all of these kept at the FEC, the FCC or the IRS, and we believe that true identity of the sponsors needs to be disclosed. And I thank you for your time.

Chairman HOUGHTON. Thank you very much.

[The prepared statement follows:]

**Statement of Glenn J. Moramarco, Senior Attorney, Brennan Center for Justice, New York University School of Law**

Good afternoon, Mr. Chairman and Members of the Subcommittee. I am a senior attorney at the Brennan Center for Justice at NYU School of Law. Thank you for the opportunity to testify at today's hearing.

The question before this Committee is whether and how, consistent with good public policy and the Constitution, to require enhanced disclosure for the political activities of tax exempt organizations. Though I will touch on a number of related issues, at the start of my testimony I want to emphasize one overarching point. I would suggest to the Committee that, apart from the Section 527 issue, which is unique and warrants separate consideration, the disclosure regime you want should not turn on whether a group is categorized as a 501(c)(4), (c)(5) or (c)(6) organization under the tax laws; rather it should turn on the specific activities in which the group is engaged. In a June 15, 2000 letter to you, Mr. Chairman, 15 of your colleagues advocated just such an approach, supporting a combination of the "McCain-Feingold-Lieberman" amendment requiring disclosures by 527 organizations with an approach to disclosure by other entities modeled on that authored by Senators Olympia Snowe (R-ME) and James Jeffords (R-VT).<sup>1</sup> These Members are, I believe, on the right track, both as a matter of policy and law.

Before turning to the remainder of my testimony, a word about my organization. The Brennan Center for Justice at NYU School of Law unites thinkers and advocates in pursuit of a vision of inclusive and effective democracy. Our mission is to develop and implement an innovative, nonpartisan agenda of scholarship, public

education, and legal action that promotes equality and human dignity, while safeguarding fundamental freedoms.

Last month, the Brennan Center published *Buying Time: Television Advertising in the 1998 Congressional Elections*, an unprecedented study which analyzed data from more than 300,000 ads aired in 1998 and created the first-ever nationwide survey of both candidate advocacy and so-called “issue advocacy.” Building on the findings in *Buying Time*, a Brennan Center Policy Committee on Political Advertising, composed of leading scholars, business leaders, and a number of your former House colleagues (including Leon Panetta, Vic Fazio, Linda Smith, and Al Swift), developed a series of policy recommendations in response to the problem of sham “issue advocacy” in American elections. Three of the recommendations made by the Policy Committee concern disclosure and are directly relevant to the work of this Committee; I describe them below. These policy recommendations and an executive summary of *Buying Time* are attached to this testimony as exhibits.

#### SUMMARY OF TESTIMONY

Determining whether and how to enhance disclosure of the political activities of tax exempt organizations has taken on increased urgency. Certain groups have recently concluded that they can organize themselves under Section 527 of the Internal Revenue Code and engage in political activity without being subject to any of the Federal Election Campaign Act’s restrictions on political committees. Thus, these Section 527 organizations are raising money from otherwise prohibited sources (corporations and unions), in unlimited amounts, and without any public disclosure. One of the primary methods that these section 527 organizations and other tax-exempt groups are using to attempt to influence the outcome of federal elections is the expenditure of enormous sums of money on so-called “issue ads.”

While before this Committee, I would like to make three general points. First, it is certainly constitutional to subject Section 527 organizations to the public disclosure rules that already govern “political committees” under FECA, and Congress should act to require full disclosure from these groups. Second, disclosing the political activity of tax-exempt groups beyond Section 527 organizations will require the Committee to make some difficult, but important judgment calls about how to appropriately define the “political activity” that will subject a group to public disclosure. In this regard, however, there are already some good working ideas already in Congress, such as the Snowe-Jeffords amendment to McCain-Feingold. Third, regardless of how broadly or narrowly the Committee decides to cast the net concerning what organizations or types of organizations should be subject to public disclosure, the Committee should also give serious consideration to how to insure that the required disclosure is adequate to meet the public’s real needs.

On the first point, virtually every news report or article that attempts to explain Section 527 organizations begins with the statement that, until recently, it was generally assumed that Section 527 organizations were subject to regulation under FECA as “political committees.” Let me suggest to you that there was a good reason for that general assumption, and that is, because Section 527 organizations are, in fact, subject to regulation as political committees under FECA (unless they engage in activity solely related to non-federal elections). We should not make the mistake of assuming that the FEC’s inaction in this area means anything other than the fact that the FEC lacks four votes to enforce currently existing law.

In the face of the FEC’s inability or unwillingness to enforce the law, it is appropriate for Congress to act and reaffirm that Section 527 organizations are “political committees.” I am aware that some have argued that it would be unconstitutional to apply FECA’s disclosure and other requirements to Section 527 organizations. That legal contention, in my view, is utterly without any merit. As I describe in more detail below, the argument that Section 527 organizations cannot be subject to federal disclosure laws stems from the mistaken impression that *Buckley v. Valeo* forbids any regulation of a group’s political activities unless the group engages in “express advocacy.” In fact, however, *Buckley* was explicit in holding that its “express advocacy” limitation was not relevant for speakers who were political candidates, political parties, or political committees. Any group that, by definition, is engaged in political activity, may be subject to reasonable disclosure rules. Section 527 organizations are, by definition, engaged in political advocacy. Just as no one would suggest that a candidate’s ads can escape regulation under FECA for failing to use “magic words” of advocacy, it is likewise true that ads sponsored by political parties or Section 527 organizations are subject to FECA even if they eschew the use of “magic words.” Congress should reaffirm what, until recently, everyone assumed was the law.

When you move beyond regulation of Section 527 organizations, then you begin to encounter constitutional line-drawing problems. I would suggest to the Committee that, apart from the Section 527 issue, which is unique, the disclosure regime you want should not turn on how the group is categorized for purposes of treatment under the tax laws. In my view, public disclosure should not turn on whether a group is registered as a 501(c)(4), (c)(5), or (c)(6) organization; rather it should turn on the specific activities in which the group is engaged. As noted above, section 527 organizations should be regulated because what they are engaged in is, by definition, political advocacy. For other groups, it should be their actions, rather than their tax-exempt status, which subject them to public disclosure laws.

In this regard, you already have some useful models in other pieces of legislation. For example, the Snowe-Jeffords amendment to McCain-Feingold contains a definition of “electioneering” which turns on meeting a certain dollar threshold on communications that are broadcast on certain specified media within a certain specified number of days before an election and that refer to a clearly identified candidate. People or groups that engage in “electioneering” whether for profit or not for profit, should be subject to reasonable public disclosure rules. Congress should act and require public disclosure of all of the non de minimus funding sources of those who sponsor electioneering communications.

Finally, on the third point, once you decide what types of organizations and activities you want to subject to public disclosure, you need to insure that the disclosure regime you adopt is effective. A fully effective system of disclosure would ensure: a) that the name of the sponsor of an advertisement appears clearly within every political ad; and b) that basic information about the sponsors of such ads is publicly and readily available. There are at least three concrete steps that Congress can and should take to meet these goals, all of which were recommended by the Brennan Center’s Policy Committee in Political Advertising. First, attribution lines (“Paid for by . . .”) need to be required for every political ad. Second, we must require full disclosure of the true identity of the sponsors of media buys. Third, we need to promulgate a single form for disclosure of political ads and create a central repository for public access to the information.

*1. Congress May Require Disclosure From Groups that, Like Section 527 Organizations, Are Organized For The Purpose Of Engaging In Political Advocacy.*

In *Buckley v. Valeo*, the Supreme Court considered the constitutional validity of, among other things, various disclosure provisions that Congress had enacted on federal political activity. In general, the Court found mandatory disclosure requirements to be the least restrictive means for achieving the government’s compelling interests in the campaign finance arena. However, the Court believed that, while it was constitutionally permissible to require advocacy groups that “expressly advocate” for or against particular federal candidates to comply with the Federal Election Campaign Act’s disclosure provisions, advocacy groups that engage in a mere discussion of political issues (so-called “issue advocacy”) could not be so required.

The Supreme Court was concerned that the Federal Election Campaign Act could become a trap for unwary political speakers. Advocacy groups or individuals that participate in the national debate about important policy issues might discover that they had run afoul of federal campaign finance law restrictions simply by virtue of their having mentioned a federal candidate in connection with a pressing public issue. The Court found that FECA’s disclosure provisions, as written, raised potential problems both of vagueness and overbreadth.

Under First Amendment “void for vagueness” jurisprudence, the government cannot punish someone without providing a sufficiently precise description of what conduct is legal and what is illegal. A vague or imprecise definition of regulated political advocacy might serve to “chill” some political speakers who, although they desire to engage in pure “issue advocacy,” may be afraid that their speech will be construed as regulable “express advocacy.” Similarly, the overbreadth doctrine in First Amendment jurisprudence is concerned with a regulation that, however, precise, sweeps too broadly and reaches constitutionally protected speech. Thus, a regulation that is clearly drafted, but covers both “issue advocacy” and “express advocacy” may be overbroad as applied to certain speakers.

The Court’s vagueness and overbreadth analysis centered on two provisions in FECA—section 608(e), which adopted limits on independent expenditures, and section 434(e), which adopted reporting requirements for individuals and groups. For these two provisions, the Supreme Court overcame the vagueness and overbreadth issues by adopting a narrow construction of the statute that limited its applicability to “express advocacy.” However, the Court made it absolutely clear that the “express advocacy” limiting construction that it was adopting for these sections *did not apply* to expenditures by either candidates or political committees. According to the Court,

the activities of candidates and political committees are “by definition, campaign related.” *Buckley*, 424 U.S. at 79.

The “express advocacy” limitation was intended by the Court to give protection to speakers that are not primarily engaged in influencing federal elections. However, because candidates and political committees have as their major purpose the influencing of elections, they are not entitled to the benefit of the “express advocacy” limiting construction. The Supreme Court never suggested, as no rational court would, that political candidates, political parties, or political committees can avoid all of FECA’s requirements by simply eschewing the use of “express advocacy” in their communications. As discussed above, the Supreme Court wanted to avoid trapping the unwary political speaker in the web of FECA regulation. However, for political parties, political candidates, and political committees, which have influencing electoral outcomes as their central mission, there is no fear that they will be unwittingly or improperly subject to regulation.

The *Buckley* Court’s first invocation of the “express advocacy” standard appears in its discussion of the mandatory limitations imposed by FECA section 608(e) on independent expenditures. Section 608(e)(1) limited individual and group expenditures “relative to a clearly identified candidate” to \$1,000 per year. The Court, in analyzing the constitutional validity of the \$1,000 limit on independent expenditures by groups and individuals, focused first on the issue of unconstitutional vagueness. The Court noted that although the terms “expenditure,” “clearly identified,” and “candidate” were all defined in the statute, the term “relative to” a candidate was not defined. *Buckley*, 424 U.S. at 41. The Court found this undefined term to be impermissibly vague. *Id.* at 41. Due to the vagueness problem, the Court construed the phrase “relative to” a candidate to mean “advocating the election or defeat of” a candidate. *Id.* at 42.

Significantly, the Court did not adopt a limiting construction of the term “expenditure,” which appears in a definitional section of the statute at section 591(f). Rather, the Court narrowly construed only section 608(e). *Id.* at 44 (“in order to preserve the provision against invalidation on vagueness grounds, § 608(e)(1) must be construed to apply only to expenditures for communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office.”). The limitations under section 608(e) apply only to individuals and groups. *Id.* at 39–40. Political parties and federal candidates have separate expenditure limits that did not use the “relative to a clearly identified candidate” language, see §§ 608(c) & (f), which was found to be problematic in section 608(e)(1).

The Court, having solved the statute’s vagueness problem, next turned to the question of whether section 608(e)(1), as narrowly construed by the Court, nevertheless continued to impermissibly burden the speaker’s constitutional right of free expression. The Court found the government’s interest in preventing corruption and the appearance of corruption, although adequate to justify contribution limits, was nevertheless inadequate to justify the independent expenditure limits. Therefore, the Court held section 608(e)(1)’s limitation on independent expenditures unconstitutional, even as narrowly construed.

In sum, in this portion of its opinion, the *Buckley* Court did not adopt a new definition of the term “expenditure” for all of FECA. Rather, the Court held that the limits on independent expenditures imposed on individuals and groups should be narrowly construed to apply only to “express advocacy,” and that these limits were nevertheless unconstitutional even as so limited. Because the limits on independent expenditures in section 608(e) were ultimately struck down by the Court, the narrowing construction of that section became, in a practical sense, irrelevant.

The only other portion of the *Buckley* decision that raises the “express advocacy” narrowing construction is the Court’s discussion of reporting and disclosure requirements under FECA section 434(e). It is here that the Court makes it absolutely clear, in unambiguous language, that *political committees and candidates are not entitled to the benefit of the narrowing “express advocacy” construction* earlier discussed in section 608(e).

The Court begins its discussion of reporting and disclosure requirements by noting that such requirements, “as a general matter, directly serve substantial governmental interests.” *Buckley*, 424 U.S. at 68. After concluding that minor parties and independents are not entitled to a blanket exemption from FECA’s reporting and disclosure requirements, the Court moved on to a general discussion of section 434(e).

As introduced by the Court, “Section 434(e) requires ‘[e]very person (*other than a political committee or candidate*) who makes contributions or expenditures’ aggregating over \$100 in a calendar year ‘*other than by contribution to a political committee or candidate*’ to file a statement with the Commission.” *Id.* 74–75 (emphasis added). The Court noted that this provision does not require the disclosure of mem-

bership or contribution lists; rather, it requires disclosure only of what a person or group actually spends or contributes. *Id.* at 75.

The *Buckley* Court noted that the Court of Appeals had upheld section 434(e) as necessary to enforce the independent expenditure ceiling discussed above—section 608(e). *Id.* at 75. The Supreme Court, having just struck down these independent expenditure limits, concluded that the appellate court’s rationale would no longer suffice. *Id.* at 76. However, the *Buckley* Court concluded that section 434(e) was “not so intimately tied” to section 608(e) that it could not stand on its own. *Id.* at 76. Section 434(e), which predated the enactment of section 608(e) by several years, was an independent effort by Congress to obtain “total disclosure” of “every kind of political activity.” *Id.* at 76.

The Court concluded that Congress, in its effort to be all-inclusive, had drafted the disclosure statute in a manner that raised vagueness problems. *Id.* at 76. Section 434(e) required the reporting of “contributions” and “expenditures.” These terms were defined in parallel FECA provisions in sections 431(e) and (f) as using money or other valuable assets “for the purpose of influencing” the nomination or election of candidates for federal office. *Id.* at 77. The Court found that the phrase “for the purpose of . . . influencing” created ambiguity that posed constitutional problems. *Id.* at 77.

In order to eliminate this vagueness problem, the Court then went back to its earlier discussions of “contributions” and “expenditures.” The Court construed the term “contribution” in section 434(e) in the same manner as it had done when it upheld FECA’s contribution limits. *Id.* at 78. It next considered whether to adopt the same limiting construction of “expenditure” that it had adopted when construing section 608(e)’s limits on independent expenditures by individuals and groups.

When we attempt to define “expenditure” in a similarly narrow way we encounter line-drawing problems of the sort we faced in 18 U.S.C. § 608(e)(1) (1970 ed., Supp. IV). Although the phrase, “for the purpose of . . . influencing” an election or nomination, differs from the language used in § 608(e)(1), it shares the same potential for encompassing both issue discussion and advocacy of a political result. The general requirement that “political committees” and candidates disclose their expenditures could raise similar vagueness problems, for “political committee” is defined only in terms of amount of annual “contributions” and “expenditures,” and could be interpreted to reach groups engaged purely in issue discussion. The lower courts have construed the words “political committee” more narrowly. To fulfill the purposes of the Act they need only encompass organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate. Expenditures of candidates and of “political committees” so construed can be assumed to fall within the core area sought to be addressed by Congress. They are, by definition, campaign related.

But when the maker of the expenditures is not within these categories—when it is an individual other than a candidate or a group other than a political committee—the relation of the information sought to the purposes of the Act may be too remote. To insure that the reach of § 434(e) is not impermissibly broad, we construe “expenditure” for purposes of that section in the same way we construed the terms of § 608(e)—to reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate.

*Id.* at 79–80 (footnotes omitted) (emphasis added).

The Court in *Buckley* could not have been more clear. When applied to a speaker that is neither a political candidate nor a political committee, the term “expenditure” in section 434(e) must be narrowly construed under the “express advocacy” standard. However, when applied to organizations that have as a major purpose the nomination or election of a candidate, the “express advocacy” limiting construction simply does not apply. The activities of these groups are, by definition, campaign related, and legitimately subject to regulation under FECA.

This, of course, is the only sensible reading of FECA. To suggest that political candidates, political parties, or political committees can escape FECA’s regulatory reach by merely eschewing the use of express words of advocacy, reduces the law to meaninglessness. It may be necessary, as the Court held, to give advocacy groups that are not primarily engaged in campaign-related activity a bright-line test that will enable them to avoid regulatory scrutiny. But organizations whose very purpose is to influence federal elections need no such safety net, and have not been given one.

## IMPLICATIONS FOR REGULATION OF SECTION 527 ORGANIZATIONS

FECA's definition of a "political committee" mirrors the Internal Revenue Service's definition of a Section 527 "political organization." Under FECA, a "political committee" is, among other things, "any committee, club, association, or other group of persons which . . . makes expenditures aggregating in excess of \$1,000 during a calendar year." 2 U.S.C. § 431(4)(A). The term "expenditures" includes, among other things, "any purchase, payment, distribution, loan, advance, deposit, gift of money or anything of value, made by any person *for the purpose of influencing any election for Federal office*." 2 U.S.C. § 431(9)(A)(i) (emphasis added).

Under the Internal Revenue Code, a Section 527 political organization is defined as "a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated *primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function*." 26 U.S.C. § 527(e)(1) (emphasis added). An "exempt function" within the meaning of section 527 "means the function of *influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed*." 26 U.S.C. § 527(e)(2) (emphasis added).

Thus, any organization that is a Section 527 organization is, by definition, organized and operated primarily for the purpose of "influencing or attempting to influence the selection, nomination, election, or appointment of any individual" to public office. See 26 U.S.C. § 527(e)(2). Such an organization satisfies the "major purpose" standard established by the Supreme Court in *Buckley*, and may therefore be subject to reasonable public disclosure of its sources of funding for its political activities. *Buckley* offered protection to issue-oriented speakers and groups that are not organized for the explicit purpose of influencing election outcomes. Section 527 organizations, however, are subject to reasonable mandatory public disclosure requirements by virtue of their central mission.

*II. When Moving Beyond Section 527 Organizations, Congress Should Require Disclosure Based on Activity, Not Tax Status. The Snowe-Jeffords Amendment Presents A Reasonable And Constitutional Model For Accomplishing This.*

The complete secrecy that surrounds contributions to and political expenditures by groups operating under Section 527 of the Internal Revenue Code is intolerable. Until recently, the one point that both supporters and opponents of campaign finance law agreed upon was the need for, at a minimum, full public disclosure of political contributions and spending. However, it would be wrong to conclude that the problem surrounding Section 527 organizations is one that stems from inadequacies in the Internal Revenue Code. There is a legitimate public policy reason why we have Section 527 organizations—political parties, like the Democratic and Republican parties, are not profit-making enterprises and there is no sound public policy reason to tax them on their receipts or expenditures.

Of course, public disclosure of the large donors to and expenditures of tax-exempt groups may be a worthy goal in its own right. Organizations that receive the public benefit of tax-exempt status should perhaps be subject to appropriate public scrutiny in exchange for that benefit. However, the major public policy problem that we are facing today is that there is an enormous potential for corruption from the massive secret fund-raising and political expenditures being made by Section 527 organizations. The fact that these organizations are also tax exempt is really incidental to the main problem of massive and secret fundraising and political expenditures.

Congress should not focus on the tax status of organizations that are involved in political activity; rather it should focus on the activities themselves. Congress needs to develop a solid, constitutional definition of "electioneering activity" which is subject to full public disclosure, with the disclosure requirement applying regardless of the tax status of the sponsoring organization. Congress will have accomplished very little if it chases the current Section 527 groups to organize themselves under different provisions of the tax code.

There are other models currently in Congress that attempt to achieve reasonable disclosure of the activity of groups engaged in political advocacy. These proposals are not geared to the tax status of the organizations that engage in the activity. For example, the Snowe-Jeffords amendment to McCain-Feingold would require, subject to certain limited exceptions, public disclosure from a sponsor who spends more than \$10,000 on communications that: (i) refer to a clearly identified candidate for Federal office, (ii) are aired within 60 days before a general election or 30 days before a primary, and (iii) are broadcast on radio or television to the electorate for the identified candidate. This is a sensible approach for delineating electioneering

speech that should be subject to public disclosure. A sponsor would be subject to disclosure requirements regardless of how it is organized for tax purposes.

Using the Snowe-Jeffords criteria to delineate which communications should be subject to disclosure as electioneering communications is constitutional. The Supreme Court has made clear that, for constitutional purposes, electioneering is different from other speech. See *FEC v. Massachusetts Citizens for Life*, 479 U.S. 238, 249 (1986). Congress has the power to enact campaign finance laws that constrain the spending of money on electioneering in a variety of ways, even though spending on other forms of political speech is entitled to absolute First Amendment protection. See generally *Buckley v. Valeo*, 424 U.S. 1 (1976). Congress is permitted to demand that the sponsor of an electioneering message disclose the amount spent on the message and the sources of the funds. This is black letter constitutional law about which there can be no serious dispute.

There are, of course, limits to Congress's power to regulate election-related spending. But Congress has broader latitude to require disclosure of election-related spending than it does to restrict such spending. See *Buckley*, 424 U.S. at 67–68. In *Buckley*, the Court declared that the governmental interests that justify disclosure of election-related spending are considerably broader and more powerful than those justifying prohibitions or restrictions on election-related spending. Disclosure rules, the Court opined, in contrast to spending restrictions or contribution limits, enhance the information available to the voting public. Plus, the burdens on free speech rights are far less significant when Congress requires disclosure of a particular type of spending than when it prohibits the spending outright or limits the funds that support the speech. Disclosure rules, according to the Court, are “the least restrictive means of curbing the evils of campaign ignorance and corruption.” Thus, even if certain political advertisements cannot be prohibited or otherwise regulated, the speaker might still be required to disclose the funding sources for those ads if the governmental justification is sufficiently strong.

Those who oppose disclosure of the type that would be required under Snowe-Jeffords and other similar approaches frequently contend that it is unconstitutional for Congress to regulate any communication that does not contain “magic words” of advocacy for or against a particular candidate. However, the Supreme Court has never held that there is only a single constitutionally permissible route a legislature may take when it defines “electioneering” to be regulated or reported. The Court has not prescribed certain “magic words” that are regulable and placed all other electioneering beyond the reach of any campaign finance regulation.

As noted in the previous section, in *Buckley*, when the Supreme Court reviewed the constitutionality of FECA, it was concerned about the clumsy way that the statute was written. However, rather than simply striking FECA and leaving it to Congress to develop a narrower and more precise definition of electioneering, the Court instead intervened and essentially rewrote Congress's handiwork itself. In order to avoid the vagueness and overbreadth problems, the Court interpreted FECA to reach only funds used for communications that “expressly advocate” the election or defeat of a clearly identified candidate. In an important footnote, the Court provided some guidance on how to decide whether a communication meets that description. The Court stated that its revision of FECA would limit the reach of the statute “to communications containing express words of advocacy of election or defeat, such as ‘vote for,’ ‘elect,’ ‘support,’ ‘cast your ballot for,’ ‘Smith for Congress,’ ‘vote against,’ ‘defeat,’ ‘reject.’” *Buckley*, 424 U.S. at 44 n.52.

But the Court emphatically did not declare that all legislatures were stuck with these magic words, or words like them, for all time. To the contrary, Congress has the power to enact a statute that defines electioneering in a more nuanced manner, as long as its definition adequately addresses the vagueness and overbreadth concerns expressed by the Court. Any more restrictive reading of the Supreme Court's opinion would be fundamentally at odds with the rest of the Supreme Court's First Amendment jurisprudence. Countless other contexts—including libel, obscenity, fighting words, and labor elections—call for delicate line drawing between protected speech and speech that may be regulated. It is doubtful that the Supreme Court in *Buckley* intended to single out election regulations as requiring a mechanical, formulaic, and utterly unworkable test.

The criteria contained in the Snowe-Jeffords amendment present a definition of electioneering carefully crafted to address the Supreme Court's dual concerns regarding vagueness and overbreadth. Because the test for prohibited electioneering is defined with great clarity, it satisfies the Supreme Court's vagueness concerns. Any sponsor of a broadcast will know, with absolute certainty, whether the ad depicts or names a candidate, how many days before an election it is being broadcast, and what audience is targeted. There is little danger that a sponsor would mistak-

only censor its own protected speech out of fear of prosecution under such a clear standard.

The prohibition is also so narrow that it satisfies the Supreme Court's overbreadth concerns. Any speech encompassed by the prohibition is plainly intended to convince voters to vote for or against a particular candidate. A sponsor who wishes simply to inform the public at large about an issue immediately before an election could readily do so without mentioning a specific candidate and without targeting the message to the specific voters who happen to be eligible to vote for that candidate. It is difficult to imagine an example of a broadcast that satisfies this definition even though it was not intended to influence the election in a direct and substantial way. Though a fertile imagination might conjure up a few counter-examples, they would not make the law *substantially* overbroad.

The careful crafting of the Snowe-Jeffords Amendment stands in stark contrast to the clumsy and sweeping prohibition that Congress originally drafted in FECA. Unlike the FECA definition of electioneering, the Snowe-Jeffords Amendment would withstand constitutional challenge without having to resort to the device of narrowing the statute with magic words. When moving beyond disclosure for Section 527 organizations, Congress should consider the Snowe-Jeffords approach as a model for requiring disclosure from all groups, regardless of how they are organized under the tax code.

### *III. Policy Recommendations for Better and Fuller Public Disclosure*

The decision concerning what types of organizations and activities to subject to public disclosure is, of course, only the first step. It is important to ensure that the disclosure regime is effective in supplying the vital information that the public needs. In *Buying Time*, the Brennan Center's study of political advertising in 1998, we discovered that the disclosure requirements under already existing Federal Communications Commission regulation are not being fully complied with. The Brennan Center's Policy Committee, which included academics, business leaders, and former Congressional Representatives (John Brademas, Vic Fazio, Leon Panetta, Linda Smith and Al Swift), made a number of recommendations for enhancing disclosure that Congress should consider.

A fully effective system of disclosure would ensure that, a) the name of the sponsor of an advertisement appears clearly within the ad and that, b) basic information about the sponsors of election advertisements is publicly available. Unfortunately, the Brennan Center Study revealed that both of these basic pieces of information were often hard to come by in 1998. Disclaimers, the portion of the ad that reads "Paid for by . . .," are for most people the only means by which to learn who sponsored the ad they are seeing, but even this minimal piece of information was missing from a sizable number of ads in 1998. The sponsorship of slightly less than one quarter of ads in the study was either missing or illegible.

One way to make the sponsorship of ads more transparent without establishing new standards for electioneering would be to use the existing statutory authority of the Federal Communications Commission (FCC). The FCC's rules apply to all noncommercial speech; their enforcement does not depend on whether an ad uses "magic words." The Brennan Center's Policy Committee recommended three separate steps for enhancing disclosure through the FCC: 1) requiring disclaimers on ads to be more prominent, 2) increasing access to existing information about media buys, and 3) preventing sponsors of political ads from hiding their identities.

In regard to the first recommendation, the FCC should enforce its existing rules on disclaimers and adopt stronger requirements for the display of sponsor information within all political advertisements. Current FCC rules maintain that sponsorship of ads with political content -whether or not they are sponsored by a candidate -must be "identified with letters equal to or greater than four percent of the vertical picture height" and must air "for not less than four seconds." 47 CFR 73.1212(a)(1)(ii). This applies to all political ads, including ones that are not explicitly campaign-related but simply "political matter or matter involving the discussion of a controversial issue of public importance," a test that includes true issue advocacy. Both the size and duration of the disclaimer could be increased, along with controls insuring that the background does not render it illegible (i.e. no black text on black background, white text on white background). In addition, it may be worthwhile to require that the sponsors of the ad be identified aurally as well as visually.

This should be an uncontroversial idea. There is ample precedent for requiring a greater proportion of a commercial to be devoted to disclaimer messages. If pharmaceutical companies are required to provide relatively extensive messages on the potential risks of their products, then certainly political advertisers should not object to taking a few minor steps to decrease the possibility of voter confusion.



The second recommendation put forward by the Policy Committee is to increase access to existing information about media buys by requiring the FCC to promulgate forms for disclosure and create a central repository for public access. For all political ads, FCC regulations mandate that their sponsors file organizational paperwork with the broadcast station for public inspection. The required organizational information includes a list of the members of the group's executive committee, board of directors, or chief executive officers. All radio and television broadcast stations and cable operators are required to keep this information available for public inspection during regular business hours.

Despite these requirements, records can be sloppy and access to the data less-than-willingly granted. The FCC could promulgate forms for disclosure and provide a central repository (perhaps at FCC headquarters or via the web) to allow easier access for citizens and journalists. Creating a clear process for disclosure of ad buys through a standardized form and through requiring stations to share this information does not represent a large change for political advertisers, who are already required to disclose their identity; it would only be part of an attempt to improve and make more transparent this already existing process.

Creating a central repository for ad buy records would, however, be a welcome change. The Federal Election Commission (FEC), whose ability to provide financial information on candidates and parties to the public is widely praised, presents itself as a model for what is possible. The FEC has also made great strides in making information available via the Internet, something the FCC or a new data center could also do.

The third recommendation put forward by the Policy Committee is to require full disclosure of the true identity of sponsors of media buys by having the FCC issue regulations or give clearer direction to television stations of what is required under existing law. Current FCC rules require that political ads must "fully and fairly disclose the true identity" of the organization paying for the ad. If the person placing the ad is known to be an agent for someone else, or if the station could determine that with "reasonable diligence," then the ad must disclose the identity of the actual sponsor of the advertisement. The regulation's scope has been substantially unexplored by the courts, and its constitutionality has not been ruled on. However, in 1996, the FCC found that a number of stations in Oregon failed to properly identify ad sponsors during an anti-smoking campaign and had failed to exercise reasonable diligence to determine the true identity of the sponsors. In that action, the ads identified "Fairness Matters to Oregonians Committee" as the sponsor, although the Tobacco Institute funded, designed, and implemented the advertisements. Notably, the FCC did not impose sanctions because the stations lacked guidance from the Commission on how they were supposed to proceed in these situations. Given the proliferation of groups such as these, it is more clear than ever that new rules for what constitutes full and fair disclosure are necessary.

The FCC's rules provide the lever to force advertisers who currently use innocuous sounding names like "Citizens for Good Government" to fully disclose their true identities—including contact information and the names of the group's principals—and require stations to exercise reasonable diligence in assembling this information. This information could be incorporated into the disclaimer within the ad or may simply be available to those who review the station's records of media buys. Requiring groups running political ads to disclose basic information (for example, a physical address, not a post office box) does not approach what groups running independent expenditures disclose to the FEC, but it provides a minimum level of information to citizens and journalists, who can then make more informed evaluations of the claims made in the ads they see.

These two disclosure requirements—the basic organizational information and the true identity disclosure—provide a hook for getting more information to the public about who is sponsoring the sham issue ads. For these steps to be effective, however, the FCC must provide stations with guidance on how they are supposed to determine the "true identity" of sponsors and what constitutes reasonable diligence when the station doubts that the identified sponsor is the true sponsor. In addition, the FCC must be willing to enforce these rules.

### Conclusions

Congress should close the loophole that allows Section 527 organizations to evade FECA requirements, most notably the requirements for full public disclosure of political expenditures. When moving beyond Section 527 organizations, Congress should regulate groups based on their actions, not their tax status under the Internal Revenue Code. The Snowe-Jeffords amendment offers a viable, constitutionally-sound model for further disclosure. Finally, the disclosure that is enacted should in-

clude requiring disclaimers on advertisements to be more prominent, increasing public access to existing information about media buys, and preventing sponsors of political ads from hiding their true identities.

[An attachment is being retained in the Committee files.]

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Chairman HOUGHTON. Mr. Makinson.

**STATEMENT OF LARRY MAKINSON, EXECUTIVE DIRECTOR,  
CENTER FOR RESPONSIVE POLITICS**

Mr. MAKINSON. Thank you, Mr. Chairman, and Members of the Committee. My name is Larry Makinson. I am executive director of the Center for Responsive Politics, which is a nonprofit research organization that monitors and analyzes campaign contributions in Federal elections. I appreciate the opportunity to address the Committee today, and I would like to address specifically the 527s. A little background first. The center was founded in 1983 by two United States senators: Hugh Scott, a Republican of Pennsylvania, and Frank Church, a Democrat of Idaho. The idea in being founded was to look at ways to make Congress more responsive to the public. And as a logical part of fulfilling that mandate, very early on, we started tracking money in politics. Our first report was back in 1984 after the presidential elections.

Beginning in 1989, we have systematically monitored all itemized contributions to Federal candidates and parties, both from PACs and individuals. We break them down by industry and interest group and we publish our findings so that anyone can see them. We used to do them in a 1,300-page book, which I have a copy here, called "Open Secrets." we now do this on the Internet. Thank God, I don't have to drag that book around as much as I used to.

Now, the—Mr. Chairman, Members of the Committee, your contributions, contributions to your reelection Committees are an open book. As you well know, all contributions over \$200 have to be itemized and reported to the Federal Election Commission. The FEC both gathers and reports that information, and any interested citizen can now look it up on the Internet. Using the information from the FEC, we at the Center compile full campaign finance profiles for every Member of Congress, all candidates for Congress and all the leading candidates for President.

Here's what we have on each one of you and on all your opponents in the 2000 election as well. First of all, a summary of how much money you have taken in this election cycle, how much you spent, how much cash you have left in the bank, how much of your money has come from PACs, how much from individuals, how much from your own pocket.

We also break down the contributions geographically. Anyone can look up your profile and find out how much of your money was collected in-State versus out-of-State. They can look up the five biggest metro areas to your campaign and your top ten ZIP codes.

They can also get a breakdown of your contributions by industry and interest group. We do this both in a broad sense, through a chart that shows all contributions in one of 13 sectors, such as health or transportation, and a more detailed level by looking at the top 20 industries giving to your campaign. This would show

how much you got from, say, securities firms, insurance companies, public employee unions, or airlines. They can also see your leading contributors standardized and grouped by organization.

We even monitor how good a job each candidate does in fully identifying the occupations and employers of their donors as required by Federal law. That is disclosure. With that information, any citizen who wants to find out who is paying for your election can do so quickly and easily.

Now, contrast that level of disclosure with the information available today on so-called 527 organizations—groups such as Republicans for Clean Air, which spent an estimated \$2.5 million on negative ads in New York, Ohio, and California in the days leading to Super Tuesday and helped derail Senator McCain's presidential campaign.

When those ads first came out, nobody knew who Republicans for Clean Air was. In fact, as later came out, there was no organization. There was only a Texas billionaire named Sam Wiley and his brother, and if Wiley hadn't stood up and said his were the dollars that were fueling those ads, we still would be scratching our heads wondering where they came from.

Under the terms of section 527, Wiley didn't have to disclose a thing—nor does anyone else. Unlimited sums can also come from corporations, labor unions, ideological and single-issue groups of all political stripes, even foreign companies, governments, despots or for that matter, the Sicilian Mafia if they had the inclination.

The fact is, if Saddam Hussein wanted to plunk \$100 million into a barrage of TV ads the final week before we pick our next President, he could do it. He could also fly under the radar with direct mail pieces or prerecorded phone messages to every mailbox and telephone in America. So could the Trial Lawyers, the Teamsters Union, Philip Morris, the National Rifle Association, the Sierra Club or Microsoft, all without anybody knowing where the money came from or how much was even spent.

This has all come about through a combination of reasons. The Federal court ruling that opened up the phenomenon of so-called "issue ads," the move by the IRS to clamp down on political activities by tax-exempt organizations, and a growing desire in an age when disclosure of contributions is improving all the time for some donors to evade public detection. They have found the ultimate loophole in these 527 Committees, which are seen as 100 percent political by the IRS, and 100 percent nonpolitical by the FEC. That legal alchemy has rendered them essentially—has rendered their finances 100 percent invisible.

I know there has been a lot of discussion about adding other groups beyond 527s to this. I would like to point out there is a crucial difference between 527s and all the other tax-exempt groups. 527s needn't be organizations at all. All they are is bank accounts, secret bank accounts, whose donors can come from absolutely anywhere in the world.

Mr. Chairman, we spend hundreds of billions of dollars a year protecting our national security, yet with this loophole we have invited anyone to potentially disrupt our elections. For the cost of a few Scud missiles, any foreign government, corporation or cartel can pour millions of dollars into influencing our elections, and they

can do it all legally and completely anonymously. That is as much a danger to the republic as any brushfire war halfway around the world. There should be no place in our American elections for secret bank accounts or phantom organizations with names that sound all-American but identities that can be anything but.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much.

[The prepared statement follows:]

**Statement of Larry Makinson, Executive Director, Center for Responsive Politics**

Chairman, and members of the committee, my name is Larry Makinson. I am executive director of the Center for Responsive Politics, a non-partisan non-profit research organization that monitors and analyzes campaign contributions in federal elections. I appreciate the opportunity to address the committee today, and I'd like to address my remarks particularly to those organizations operating under section 527 of the Internal Revenue code.

A little background first. The Center for Responsive Politics was founded in 1983 by two U.S. Senators—Hugh Scott, Republican of Pennsylvania, and Frank Church, Democrat of Idaho. It was founded with the idea of looking at Congress and finding ways to make it more responsive to the public. As part of that mandate, the Center first examined the relationship between money and politics quite early in its history. Our first report on the subject reviewed contribution patterns in the 1984 presidential elections. Since 1989, and proceeding right up to the present, we have systematically monitored all itemized contributions to federal candidates and parties, both from PACs and from individuals. We break them down by industry and interest group, and we publish our findings so that anyone can see them. We used to do this in a 1,300 page book called "Open Secrets" and published by Congressional Quarterly. Nowadays we publish it solely on the Web, on our [opensecrets.org](http://opensecrets.org) website.

Mr. Chairman, members of the committee, your contributions—contributions to your reelection committees—are an open book. As you well know, all contributions over \$200 have to be itemized and reported to the Federal Election Commission. The FEC both gathers and reports that information, and any interested citizen can now look it up on the Internet. Using that information, we at the Center compile, and publish on the Web, full campaign finance profiles for every member of Congress, all candidates for Congress, and the leading contenders for President.

Here's what we have on each one of you—and all your opponents in the 2000 elections, as well. A summary of how much money you've taken in this election cycle, how much you've spent, how much cash you have left in the bank, and how much of your money has come from PACs versus individuals, versus money from your own pocket. We also break down the contributions geographically. Anyone can look up your profile and find out how much of your money was collected in-state versus out-of-state. They can look up the five biggest metro areas contributing to your campaign, as well as your top 10 zip codes.

They can also get a breakdown of your contributions by industry and interest group. We do this both in a broad sense, through a chart that divides all your contributions into one of 13 broad sectors—such as Health or Transportation—and on a more detailed level by looking at the top 20 industries and interest groups giving to your campaign. This would show how much you got from, say, securities firms, insurance companies, public employee unions, or airlines. They can also see your leading contributors, standardized and grouped by organization. We even monitor how good a job each candidate does in fully identifying the occupation and employers of their donors, as required by federal law.

That's disclosure. With that information, any citizen who wants to find out who's paying for your election can do so, easily and quickly.

Contrast that level of disclosure with the information available today on so-called "527 organizations"—groups like Republicans for Clean Air, which spent an estimated \$2.5 million on negative ads in New York, Ohio and California in the days leading to Super Tuesday—ads that helped bring to an end the presidential campaign of John McCain.

When those ads first came out, nobody knew who Republicans for Clean Air was. In fact as later came out, there *was* no organization. There was only a Texas billionaire named Sam Wyly, and his brother. And if Wyly hadn't stood up and said it was his dollars that were fueling those ads, we'd still be scratching our heads won-

dering where they came from. Under the terms of Section 527, Wyly didn't have to disclose a thing.

Nor does anyone else. Unlimited sums can also come from corporations, labor unions, ideological and single-issue groups of all political stripes—even foreign companies, governments, despots, or for that matter the Sicilian Mafia, if they had the inclination. The fact is, if Saddam Hussein wanted to plunk \$100 million into a barrage of TV ads the final week before we pick our next president, he could do it. He could also fly under the radar with direct mail pieces, or pre-recorded phone messages, to every mailbox and telephone in America.

So could the American Trial Lawyers Association, the Teamsters Union, Philip Morris, the National Rifle Association, the Sierra Club, or Microsoft—all without anybody knowing where the money came from, or how much was even spent.

This has all come about through a combination of reasons—the federal court ruling that opened up the phenomenon of so-called “issue ads,” the move by the IRS to clamp down on political activities by tax-exempt organizations, and a growing desire—in an age when disclosure of contributions is improving all the time—for some donors to evade public detection.

They have found the ultimate loophole in these 527 committees, which are seen as 100% political by the IRS, and 100% non-political by the FEC. This legal alchemy has effectively rendered their finances 100% invisible.

I know there's been much discussion lately about expanding this legislation to include not simply 527's, but to require disclosure of other tax-exempt organizations attempting to influence elections as well. The one thing I would point out, however, is that there's a difference—a crucial difference—between 527s and all the other tax-exempt groups.

As “Republicans for Clean Air” has all too clearly demonstrated, a 527 needn't be an organization at all. All it is is a bank account. A secret bank account, whose donors can come from absolutely anywhere in the world.

Mr. Chairman, we spend hundreds of billions of dollars a year protecting our national security, yet with this loophole we have invited anyone in to potentially disrupt our elections. For the cost of a few Scud missiles, any foreign government, corporation, or cartel could pour millions of dollars into influencing our elections. They could do it legally and completely anonymously.

That's as much a danger to this republic as any brushfire war halfway around the world. I'm glad it's getting attention here in Congress, and I hope you'll shut this loophole down as quickly as possible. There should be no place in our American elections for secret bank accounts or phantom organizations with names that sound all-American, but identities that could be anything but.

Thank you, and I'd be happy to answer any questions you may have.

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Chairman HOUGHTON. Ms. Hill.

**STATEMENT OF FRANCES R. HILL, PROFESSOR, UNIVERSITY  
OF MIAMI, SCHOOL OF LAW**

Ms. HILL. Thank you, Mr. Chairman. I am Frances Hill. I am a professor at the University of Miami School of Law. My testimony today does not represent the views, if any, of the University of Miami on these topics. I appreciate the opportunity to be here today.

The intense focus on the right of contributors that dominates current debates, both academic and legislative, over campaign finance reform threatens to obscure the consideration of the rights of voters as participants in campaigns and elections. Elections are held so that citizens can exercise their sovereign authority to choose their elected representatives. governments chosen in elections are legitimate and effective to the extent that citizens have confidence that their choices matter. I am here today to urge you to remember the voters by ensuring that the voters have the information that they require.

You have heard much today about the secrecy of the new section 527 organizations and about how that secrecy occurs. I would like to make four points about the potential consequences of allowing the section 527 stealth funds to go unchecked:

One, they intend to obscure and confuse the voters by providing information under innocuous-sounding names. This is not anonymous political speech. This is pseudonymous political speech in the name of another, and it does not serve the interest of informing the voters.

Two, the new section 527 stealth funds may well suck money, oxygen, and legitimacy, in fact, out of the old section 527 organizations, the political parties and the candidate Committees. It is interesting to me that many national political leaders of both parties now do not seem to feel that working through their own campaign Committees and their own political parties is sufficient, and they need to affiliate themselves loosely or closely, as the case may be, with secret bank accounts that the voters know nothing of.

Three, the secrecy of the stealth funds fuels public concern that powerful national political leaders are using them to levy a toll charge for access to the legislative process. This is what the economists have called "rent seeking." Congress should have a strong incentive to blunt this perception by meaningful disclosure.

Four, it appears technically possible, some of the money collected in these secret bank accounts to private individuals for their private uses although I doubt that this is in the mind of anyone involved with new section 527 organizations. It would appear that the ethics rules of the House and the Senate would prevent current Members engaging in this practice, but I urge Congress to determine whether such transfers are possible, to take steps to ensure that this practice is not possible, and to assure the American people that the new 527 organizations are not slush funds for the personal use of Members.

Disclosure seems to me an adequate remedy for all of these problems, and I think that Mr. Doggett's bill, among others, provides a workable disclosure system, well adapted to the reality of the new section 527 organizations.

Let us be clear. These organizations are already disclosing to the candidates or parties or caucuses whom they wish to support. Only the voters do not know where the money is coming from and why it is being contributed. Since we already have selective disclosure, we should extend disclosure to include the voters.

The current debate over whether we should deal with the section 527s alone, or with other organizations, is a worthy debate, but it should not be a debate that allows us to say, since we cannot be perfect, we are going to allow these truly unusual secret checking accounts to play a role in our elections. Section 501(c)(4), (5), and (6) organizations have other purposes and already disclose a great deal. In the future, you may certainly wish to consider fuller disclosure by them, as well; but now I would urge you to remember the voters in this election cycle and to enact legislation that discloses the existence and the contributors to the new 527 stealth funds.

Thank you.

Chairman HOUGHTON. Thanks very much.

[The prepared statement follows:]

**Statement of Frances R. Hill, Professor, University of Miami School of Law**

I am a professor of law at the University of Miami School of Law. My academic research deals in substantial part with tax exempt organizations and with their political activities. The views expressed in this testimony are based on my research and do not reflect the views of the University of Miami or of any client. None of this research has been supported by federal government grants or contracts.

I support enactment of disclosure requirements applicable to certain structures claiming exemption from taxation under section 527 of the Internal Revenue Code of 1986, as amended (the "Code"). In my view, disclosure requirements are necessary to provide voters with information relevant to their voting decisions. My testimony will discuss the legal basis of the new section 527 organizations, the reasons for disclosure, and the distinctions between the appropriate disclosure rules for new section 527 organizations and certain organizations treated as exempt from taxation under section 501(c).

*I. Structure of the New Section 527 Organizations*

Section 527 was enacted to resolve tax uncertainty relating to the taxation of political contributions. It protected candidates from inclusion of political contributions in their personal gross income and also provided that political contributions would be taxed if they were not used for exempt activities but had been used to earn investment income. For purposes of section 527, exempt function is defined as "the function of influencing or attempting to influence the selection, nomination, election or appointment of an individual to any federal, state, or local public office of office in a political organization, or the election of presidential or vice-presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed." Section 527(e)(2). The organizations that were covered by section 527 were political parties, candidate committees, and separate segregated funds, more commonly known as political action committees ("PACs").

Section 527 political organizations are not required to apply for recognition of exempt status or to file annual information returns. They file a tax return on Form 1120-POL only if they have investment income and use their income for expenditures inconsistent with purposes set forth in section 527(e)(2). Form 1120-POL is a corporate return that cannot be disclosed to the public.

Recently, section 527 has been used as the statutory basis for "new section 527 organizations," which might more descriptively be called "stealth funds."<sup>1</sup> These new structures exist at the intersection of the Code and the Federal Election Campaign Act (the "FECA") and exploit the ambiguities of each to create a structure that can collect and distribute unlimited amounts of money from any donor, foreign or domestic, in total secrecy.

These "new section 527 organizations" or "stealth funds" are exempt from taxation under section 527 because their sole purpose is to influence electoral outcomes within the meaning of section 527(e)(2). The Internal Revenue Service (the "IRS") has issued four private letter rulings showing how organizations qualify for exempt status under section 527. Priv. Ltr. Rul. 9652026 (December 27, 1996); Priv. Ltr. Rul. 9725036 (June 20, 1997); Priv. Ltr. Rul. 9808037 (November 21, 1997); and Priv. Ltr. Rul. 199925051 (March 29, 1999). These rulings were sought by the new section 527 organizations and their issuance does not suggest that the new section 527 organizations are required to apply for recognition of exemption. These private letter rulings suggest that it is apparently sufficient to represent to the IRS that the organization intends its political communication influence electoral outcomes. Other factors such as the expert opinion of a political scientist that the organization's communications or other activities could affect electoral outcomes might also be sufficient. Certain of these organizations described their materials as "politically biased" and used such asserted bias as support for their claim that they were organized for the purpose of influencing electoral outcomes under section 527. In sum, it appears to be quite simple to choose to satisfy the requirements for exemption under section 527. Like all other section 527 organizations, the new section 527 organizations are not required to file annual information returns. If they do file a Form 1120-POL, which most will presumably be able to avoid, this form cannot be disclosed to the public and, in any case, contains little information. Unless a new section 527 organization files a Form 1120-POL, the IRS has no way of learning of the existence of these organizations.

<sup>1</sup>Frances R. Hill, Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle, Tax Notes (January 19, 2000) and 26 Exempt Organization Tax Review 205 (November 1999).

At the same time, the new section 527 organizations claim that they are not required to disclose their existence or their sources or uses of funds to the Federal Election Commission ("FEC") because they do not engage in express advocacy, do not coordinate their activities with a candidate, and are not themselves political committees. Each of these issues is subject to substantial uncertainty under current law. The application of current election law to the new section 527 organizations remains to be addressed by the FEC. In this state of indeterminacy, the new section 527 organizations are not subject to FEC limitations or disclosure requirements.

If a stealth fund uses its money to influence an election without engaging in the type of express advocacy or coordination that causes its expenditures to be characterized as contributions or independent expenditures within the meaning of the FECA, these stealth funds are not subject to the FECA limitations on the identity of contributors or the amount of contributions. Foreign source funds in unlimited amounts could be received without becoming subject to taxation or to disclosure to the FEC or to the public. Corporate treasury funds, union treasury funds, and unlimited individual contributions could also be received without taxation and without disclosure to the FEC and the public.

The new section 527 organizations need not be organizations in any conventional sense. There is no requirement that they incorporate under state law or that they have members. A stealth fund may be simply a checking account with a separate taxpayer identification number. That checking account need have only one source of funds.

## *II. Reasons for Using New Section 527 Organizations*

The primary reason for using a new section 527 organization is to avoid both taxation and the limitations and disclosure requirements of the FECA when collecting or making very large contributions to influence electoral outcomes. These structures seem to be chosen by wealthy individuals, powerful national political leaders, and by certain advocacy organizations exempt under section 501(c). It is unclear whether corporations or labor unions or foreign persons are establishing their own new section 527 organizations or simply funding stealth funds established by others. These persons have several other alternatives for making their views known to the public, but none of these alternatives provides the same degree of secrecy as do the new section 527 organizations. Considering the available alternatives underscores the importance of the stealth element of the new section 527 organizations. The Supreme Court held in *Regan v. Taxation with Representation*, 461 U.S. 540 (1983) in upholding the limits on lobbying by section 501(c)(3) organizations that the rights of speech and association did not require that every type of organization be available for all purposes, only that some reasonable organizational form be available.

A candidate for public office may organize a principal campaign committee and as many other political committees as he or she wishes. In addition, political parties may raise money for candidates. All of these organizations are political committees subject to the limitations and disclosure requirements of the FECA.

An individual who has already reached his or her contribution limitation could contribute unlimited amounts of soft money to a political party, but this amount would be disclosed under the FECA because the recipient organization is a political committee.

A corporation or a labor union or a trade association cannot use its treasury funds for hard money contributions or independent expenditures, but each can organize a separate segregated fund under section 527(f)(3). These section 527(f)(3) PACs are subject to FEC disclosure. In addition, a corporation or a labor union or a trade association can use its treasury funds for soft money contributions to political parties, but these soft money contributions are also subject to disclosure to the FEC and to the public.

There are many structures for political speech funded with disclosed funds. New section 527 organizations are distinctive and, to some, particularly desirable, because they provide a structure for political speech with undisclosed funds.

## *III. Consequences of the New Section 527 Organizations*

The new section 527 organizations serve the interests of those who want additional scope for influencing electoral outcomes without revealing their roles to the voters, including powerful political leaders who choose to work outside their own political parties.

There are several consequences of the use of new section 527 organizations that would not appear to be beneficial under standard concepts of democratic participation and representation. The primary problem is the lack of information to the voters. Voters have a legitimate interest in information about the source of the funds for organizations established for the sole purpose of influencing elections, and gov-



ernment has a duty to ensure that voters receive the information they need to evaluate political communications in making their voting decisions. New section 527 organizations engage not simply in anonymous speech but in pseudonymous speech. There has been no determination by the courts on anonymous speech in political campaigns. If a political communication is identified as having been paid for and reflecting the views of “anonymous,” the voters are told that the funder does not wish to be identified publicly with the views and may draw their own conclusions. If a political communication is identified as coming from a group with an innocuous or even patriotic and virtuous name, voters have no way of knowing that the communication is from the secret contributor now recast as an organization. The issue is not one of prohibiting the speech but one of giving voters information about the speaker when the organization is the alter ego of a funder or a conduit for the money and views of another.

The second problem is the potential competition for contributions between the new section 527 organizations and political parties. While there is no reason to think that total contributions are fixed or that there is a zero-sum relationship between political parties and new section 527 organizations, there is also no reason to assume that political money is unlimited. Political parties disclose their contributors. Even more importantly, political parties represent voters and express their preferences on a broad range of issues. New section 527 organizations may represent only a narrow concern of one contributor. The point is not to articulate positions that will build public support but to induce gratitude in candidates who benefit from the expenditures with a view to eventual legislative support. The new section 527 organizations might well weaken political parties in their public aspect relative to the new section 527 organizations. The 2000 general election may well become a contest between the old section 527 structures, the political parties and the candidate committees, and the new section 527 stealth funds.

The third problem is the potential impact on the legislative process. Certain of the stealth funds appear to be linked with members of Congress. The danger is that the stealth funds can be used for what economists term “rent seeking.”<sup>2</sup> Indeed, the total secrecy of the new section 527 organizations makes them a potentially useful structure for collecting the proceeds of rent extraction. Any powerful national leader could organize several new section 527 organizations for this purpose. The money so collected could be used to influence electoral outcomes or to threaten to influence electoral outcomes. This would include funding primary opponents for the purpose of defeating nettlesome Congressional colleagues within the member’s own party. Whether any such transactions have yet occurred cannot be determined when even the existence of the new section 527 organizations is unknowable. Permitting certain political leaders to amass private war chests with no disclosure and no accountability in the use of the funds raises this possibility. In the worst case, such uses of new section 527 stealth funds would interfere with the relationship between other members of Congress and the people who support them with disclosed contributions and with their votes. Interposing those leaders controlling the most successful new section 527 organizations between other members of Congress and their constituents calls for a redefinition of representation in ways that appear inconsistent with citizen sovereignty.

The fourth potential problem is that the funds collected in new section 527 organizations appear to be transferable to candidates for private use, at least once they leave office, or to other private persons for their private use. Congress has determined that any money left in official campaign committees may no longer be converted to personal use upon the payment of appropriate taxes, which the law previously permitted. To the extent that the new section 527 organizations now provide a means of again taking money for eventual personal use, this would appear inconsistent with the prior reform. This possibility is an example of the unintended consequences of the new section 527 organizations. I urge Congress to determine whether this apparent technical possibility is indeed a possibility and, if it is, to take immediate action to eliminate it and to enact a disclosure system allowing the American people to have complete confidence that it has been eliminated.

#### *IV. Disclosure Remedies for the Problems Posed by the New Section 527 Organizations*

Disclosure is an appropriate remedy for the problems posed by the new section 527 organizations. Disclosure remedies raise questions regarding what information should be disclosed to whom on what schedule and with what consequences in the

<sup>2</sup>George J. Stigler, *The Citizen and the State: Essays on Regulation* (Chicago: University of Chicago Press, 1975); Fred McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion* (Cambridge: Harvard University Press, 1997).

event of noncompliance. In the case of the new section 527 organizations, the minimum goal of disclosure should be to provide the public at least as much information as is provided with respect to the sources and uses of soft money.

The first step is to require disclosure of the formation and continued existence of new section 527 organizations. In addition, disclosure of the persons who formed the organization and who are responsible for its continued operation should be disclosed. These disclosure requirements should be stated in terms that take account of the informal structures of at least some of the stealth funds. Statutory references to boards of directors or particular roles associated with organizations with more formal structures under state law would limit the scope of the provision.

Disclosure of contributors and the amount of their contributions is vital to any meaningful disclosure provision. This is information that is already disclosed with respect to soft money. There is no distinction between soft money and the funds collected by the new section 527 organizations for the sole exempt purpose of influencing electoral outcomes as provided in section 527(e)(2) that would support the continued nondisclosure of the contributors to the new section 527 organizations.

Disclosure requires an effective anti-conduit provision to prevent the use of multiple intermediary organizations to defeat disclosure. The principle should be that all the intermediaries that do not report to the FEC should be disclosed and contributors to them should be disclosed.

Disclosure of the contributors and the amount of their contributions is unlikely to be unduly burdensome. While little is known about the contributors to the new section 527 organizations, those that have come to light have been campaign finance structures for collecting a limited number of very large contributions. Indeed, collecting very large amounts is seen as more efficient with lower transaction costs than collecting money from ordinary American voters in amounts they might be able to afford to contribute.

Disclosure of the expenditures of the new section 527 organizations is also a necessary part of any meaningful disclosure remedy. This information gives the voters additional information about the entity and the contributors. It also provides information about the funding of political communications by other organizations. The use of multiple intermediary organizations has become quite common in campaign finance and the public deserves to have information about the ultimate sources of the funding of political communications.

Disclosure to the IRS is appropriate since the new section 527 organizations base their structures on section 527 of the Code and because these structures enjoy the benefits of exemption from taxation. The IRS has a duty to the public to ensure that exemption from taxation is appropriate and that structures that claim exemption are operating in a manner consistent with the statutory requirements. The Joint Committee on Taxation has issued a report on disclosure with respect to various types of exempt organizations. See, Joint Committee of Taxation, Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998: Volume II: Study of Disclosure Provisions Relating to Tax-Exempt Organizations (JCS-1-00)(January 28, 2000) and has called for increased disclosure in certain areas and for consideration of increased disclosure in other areas, including the new section 527 organizations.

The timing of disclosure is more difficult in the case of electoral disclosure than in the case of ordinary filing of a tax return or an information return. An election fixes the last date on which the information is of immediate use to the public, and the benefits to the public are the primary reason for any disclosure requirement. Disclosure to the public without delay is a foundation of a meaningful disclosure regime.

Finally, appropriate sanctions must apply in the event of noncompliance. These sanctions should exceed a mere cost of doing business and serve as a disincentive to noncompliance.

I believe that HR 4168 sets forth a workable disclosure regime adapted to the realities of the new section 527 organizations.

### V. Electoral Roles of Other Exempt Organizations

Section 501(c)(4) social welfare organizations, section 501(c)(5) labor unions, and section 501(c)(6) trade associations may also function as means of collecting and deploying undisclosed political money. In the 1996 campaign certain section 501(c)(4) organizations appear to have played this role.

Each of these organizations can be distinguished from the new section 527 organizations. The most obvious difference is that these organizations are required to file for recognition of exemption and each files an annual information return that must be disclosed to members of the public upon request. Another important difference is that each of these organization is granted exemption for a purpose other than influencing electoral outcomes and this exempt purpose must be the organization's primary purpose. Yet another difference is that section 501(c)(5) labor organizations and section 501(c)(6) trade associations have members. These organizations are supported primarily by dues paid by their members and the identity of their members can be determined from their exempt purpose and from their publicly disclosed information. None of these organizations is a stealth organization in the same manner as are the new section 527 organizations.

At the same time, these organizations are characterized by a certain degree of organizational opacity that makes them useful for collecting political money and serving as the alter egos of large contributors or a conduits for contributions earmarked for political use. Like the new section 527 organizations, section 501(c)(4) organizations may collect unlimited amounts of money from any contributors, whether domestic or foreign, including money from political parties or, indeed, from new section 527 organizations. Information on categories of expenditures is included on the annual information returns of section 501(c)(4) organizations, but this information does not identify the recipients of transferred funds.

Section 501(c)(4) organization may engage in a certain amount of activity that is characterized as "participation or intervention" in a political campaign, the kind of activity that would jeopardize the exempt status of section 501(c)(3) organizations, but this may not be the organization's primary activity. Section 527(f)(1) provides that a section 501(c)(4) organization or other section 501(c) organization that engages in section 527 (e)(2) activities is subject to the tax levied on the investment income of section 527 organizations. This tax is likely to be minimal in most cases.

Even though section 501(c)(4) organizations that engage in section 527(e)(2) activities are subject to tax, section 501(c)(4) organizations are not subject to any of the disclosure requirements that apply under the FECA. Because the section 501(c)(4) organization reports its section 527(e)(2) activities on Form 1120-POL, this information may not be disclosed to the public. In any event, it is likely that few section 501(c)(4) organizations file a Form 1120-POL. It is likely that most section 501(c)(4) organizations take the position that their activities are educational activities not undertaken to influence electoral outcomes within the meaning of section 527(e)(2). Because the IRS has based qualification for exemption under section 527 on the organization's statements regarding its intent to influence elections, structures engaging in identical activities in practice have the choice of claiming exemption under section 501(c)(4) or section 527. If they claim exemption under section 501(c)(4), they will claim that their activities are educational and if they claim exemption under section 527 they will claim that they intend that their activities influence electoral outcomes within the meaning of section 527(e)(2).

One difference between section 527 organizations and section 501(c)(4) organizations is that contributions to section 501(c)(4) organizations appear to be subject to the gift tax under section 2501(a)(5). The possibility of the imposition of the gift tax has meant that section 501(c)(4) organizations are less attractive for large contributors who could become liable to substantial amounts of gift tax. The new section 527 organizations offer an alternative that is not subject to the gift tax and that at the same provides an even greater degree of organizational opacity than do section 501(c)(4) organizations which are subject to the section 6033 filing requirements and the section 6104 public disclosure requirements.

Section 501(c) organizations already provide substantial amounts of information to the IRS and to the public. They are not required to disclose their members or their contributors to the public or to the government. However, there is no absolute prohibition on disclosure of contributors. Indeed, certain section 501(c)(4) organizations which are granted an exception from treatment as corporations prohibited from using their treasury funds for campaign activities are required to disclose certain information relating to contributors and expenditures to the FEC. These section 501(c)(4) organizations are permitted to use their treasury funds for direct campaign activities under *FEC v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986). The Supreme Court made no exceptions to the disclosure requirements for these organi-

zations. Regulations under the FECA require that they comply with disclosure requirements. 11 CFR 114.10 and 11 CFR 109.

It would, in my view, be appropriate to require that section 501(c)(4) social welfare organizations, section 501(c)(5) labor unions, and section 501(c)(6) trade associations disclose their substantial contributors and the amount of their contributions to the IRS and to the public. Disclosure of substantial contributors would provide information on sources of funding other than membership dues or the ordinary contributions from ordinary Americans who associate together for such organizations' exempt purposes.

Rules focused on substantial contributors find precedent in existing law applicable to exempt organizations. Section 4958 already requires disclosure of substantial contributors in the case of section 501(c)(4) organizations in certain circumstances. Section 4941 imposes special rules on private foundations in dealings with substantial contributors.

Disclosure of substantial contributors would provide information to the public on persons whose financial contributions might be sufficient to shape the political positions of the organization. Disclosure would also prevent abuse of exemption and of exempt organizations as alter egos or as conduits serving private interests and not the public interests for which exemption was granted.

All section 501(c) organizations already provide information on their annual information returns on their expenditures. They should be required to disclose their expenditures of any amounts that would qualify as section 527(e)(2) expenditures on the same terms and on the same schedule that section 527 organizations are required to report. Section 527(f)(1) makes section 527 applicable to such organizations under current law.

Any distributions to other section 501(c) or section 527 organizations should be disclosed to the public. Transfers of funds among entities is part of the challenge to voters in evaluating political communications. Such transfers make it unclear whether organizations are speaking in an organizational voice or in the voice of a substantial contributor. Transfers among organizations compound the difficulty for voters.

## VI. Conclusions

The intense focus on the rights of contributors that dominates current debate over campaign finance reform threatens to obscure consideration of the rights of voters as participants in campaigns and elections. Elections are held so that citizens can exercise their sovereign authority to choose their elected representatives. Governments chosen in elections are legitimate and effective to the extent that citizens have confidence that their choices matter. Disclosure is one element in ensuring that the rights and duties of voters are respected and that the political system reflects the well-informed and well-considered choices of a free and sovereign people. Voters, not just contributors, have rights and disclosure helps protect those rights.

The new section 527 organizations represent a direct threat to the rights of voters. Pseudonymous speech makes it impossible for citizens to evaluate communications and thereby inhibits political discourse. Voters have a right to know who is speaking and to evaluate the communication as they see fit. They may ignore or discount the information, but they should not be denied such information. I urge Congress to remember the voters in its deliberations on disclosure and other campaign finance issues.

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Chairman HOUGHTON. Mr. Potter—by the way, let me say, we are going to try to keep this thing going. At the end of this vote, I will try to go over and vote—and vote for the next one and come back; and in the meantime, Mr. Portman is coming back. So we will have sort of a sliding show, but we are trying to keep it going to help you with your time.

Thanks.

**STATEMENT OF HON. TREVOR POTTER, SENIOR FELLOW,  
BROOKINGS INSTITUTION; AND PARTNER, WILEY, REIN &  
FIELDING (FORMER COMMISSIONER, AND FORMER CHAIR-  
MAN, FEDERAL ELECTION CAMPAIGN)**

Mr. POTTER. Thank you, Mr. Chairman. Particularly in view of that, I will attempt to be brief. I have written testimony and would ask permission to submit that for the record. I am speaking today, representing myself as a lawyer in private practice, but not speaking on behalf of any of my clients, or my firm's clients.

I want to commend the Committee for taking a look at this issue. Disclosure in Federal elections is an increasingly important issue and a problem. The problem comes about, as you have heard today, both because of the accidental treatment really of 527s and because there has been a movement of Federal election funds out of political Committees that reported to the FEC and into these other organizations, whether they are 527s or other types that exist on the edges of Federal election law, influence Federal elections, and do not report or disclose.

The principal thrust of my testimony today as explained in some length in my written submission is that disclosure is constitutional. The Supreme Court in the Buckley case said that Congress did it wrong, that Congress used vague language—"for the purpose of influencing;"—and the Court said nobody is going to know what that means, and it is not fair to have potential criminal liability when you cannot tell, looking at the statute, whether your activity is covered or not.

As a result, the Supreme Court said since Congress wrote something that nobody can figure out, we are going to write a more precise definition. That is not the only definition that could be adopted. It is the one the court chose then in the absence of anything else from Congress.

So my message to you today is that you can adopt, I believe, a broader definition of Federal political activity involving Federal candidates, and you can require disclosure of that activity. You have to be careful when you do it that that is not so vague or so overly broad that the Court says it goes too far, but I think you can go further than you have to date.

There are three reasons that the Court said it is permissible to allow disclosure of Federal activity, and these are from the Buckley case, but they apply equally well to many of the issues you have before you now.

First, the Court recognized that providing the electorate with information in order for the electorate to evaluate those seeking Federal office is important. The Court said the disclosure allows voters to place each candidate on the political spectrum more precisely than is often possible merely on the basis of party labels and campaign speeches. So you have the Court saying the information conveyed by who is communicating is actually important.

Second, the Court said you deter actual corruption with disclosure and they said a public armed with information about "a candidate's most generous supporters is better able to detect any post-election special favors that may be given in return." This is true whether this is activity by a 527 or a direct contribution to a candidate.

Finally, the Court said that disclosure is useful in deterring and detecting violations. Public access to recordkeeping and who is spending enables people to figure out whether the campaign finance laws are being followed.

I would have a couple of specific suggestions for you. They are also outlined in my testimony as you look at a disclosure system.

First, it is important that you be crystal clear what speech is covered and what is not. That is why I think a bright-line test, such as the name or likeness of a Federal candidate, is important.

Second, it is important under the NAACP, the Alabama case, that you provide some out or exemption for people who would have a serious threat of reprisal. The Supreme Court has effectively done that in the Socialist Workers Party case for the Federal election laws, and you should do it here.

Third, I think it is important that you limit disclosure to however you define major funders, using either a dollar minimum or a percentage of the organization's total budget. The tax laws, through the 1990s, already require disclosure of people who contribute \$5,000 or more. Congressman Castle's bill talks about \$1,000.

I would urge you not to go down to either all contributors or even the Federal election campaign Act's \$200 contributor, because I don't think you need that to get at what you are looking for, which is who is actually financing these communications. It is very useful to limit the reach of the disclosure provisions to a period close to an election, whatever number of days you set.

I think it is also useful to limit disclosure to communications that are communicated broadly to the general public, either through radio and television or mass mailings. I would note in the McIntyre case, which is sometimes cited as a change in the Supreme Court jurisprudence, they were not dealing with communications that were televised or distributed through mass mailings.

It is important that the disclosure provisions be easy to administer, and finally, I would suggest that you would want to incorporate an exemption for news media activity, as the Federal election law does.

Thank you.

Mr. PORTMAN [presiding]. Thank you, Mr. Potter.

[The prepared statement follows:]

**Statement of Hon. Trevor Potter, Senior Fellow, Brookings Institution; and Partner, Wiley, Rein & Fielding (former Commissioner, and former Chairman, Federal Election Commission)**

Mr. Chairman, and Members of the Subcommittee:

Thank you for your invitation to appear today. I am a lawyer in private practice, and regularly speak, write and teach on election law issues. I have served as a Commissioner of the Federal Election Commission. My testimony today is mine alone, and is not offered on behalf of anyone else, including any client of my law firm's.

This testimony will first discuss the issue of candidate-specific activity by Section 527 political organizations which are not registered and disclosing their activities and donors to the public through any federal, state or local campaign finance agency. Then, it will discuss the suggestion that certain Section 501(c) organizations be required to disclose their federal candidate-specific political activities and, to some extent, their donors. It then notes the existence of not for profit and for profit business entities without Section 501(c) status, and the implications this has for disclosure policy. Finally, my testimony will review the constitutional and statutory construction issues that by necessity guide any legislation in this area. It is my hope in this final section of my testimony to offer guidance to the Committee that may be helpful as it considers potential legislation in this area.

### *I. Section 527 Organizations*

Section 527 of the tax code grants an exemption from income tax to organizations formed for the explicit purpose of influencing elections (whether federal, state or local) and nominations for federal office. There is no application procedure for qualification or recognition (unlike other tax exempt entities). This is because entities qualifying were assumed to be almost exclusively federal or state candidate committees, party committees, and PACs, all of which are already registered and reporting with a campaign finance disclosure agency. Section 527 was enacted specifically because these organizations wanted a clear statutory statement that political contributions to political committees, used for political purposes, were not taxable as income to those entities.

Since the 1970s, however, regulatory interpretation and constitutional law, beginning with the *Buckley v. Valeo* case, (424 U.S. 1, 1976) have combined to create a new category of political speech and activity—communications intended to influence federal elections, using every device known to modern advertising to exert such influence—but which do not “expressly advocate the election or defeat of a federal candidate.” It has become a widely held view, supported by many legal practitioners, that groups organized for the sole purpose of influencing federal elections, and engaging solely in speech attacking or praising specific federal candidates—sometimes without even the pretense of an “issue” except the qualifications of a candidate to hold office—are not engaged in federal political activity requiring registration and reporting of these expenditures, and adherence to the ban on corporate, labor, and foreign money in federal elections.

This interpretation presents an increasingly apparent gap between the coverage of the federal election laws and the terms of Section 527 of the tax code. Thus, organizations attempt to avoid the disclosure provisions and limits of the federal election laws by carefully refraining from “expressly advocating the election or defeat” of a candidate, while still claiming to qualify as a “political organization” that exists to “influence federal elections” and is therefore exempt from federal income tax under Section 527 of the tax code. This is the origination of the suddenly famous “stealth PACs.”

The appeal of 527s to donors and political activists is easy to understand, though also the result of some coincidental events. Contributions to “stealth 527s” are not disclosed to the IRS or otherwise made public (because Congress didn’t require them to be, assuming that they were already reporting elsewhere) and are not disclosed to the FEC because the organizations are not registered political committees. Contributions to 527 organizations are specifically exempt from the federal gift tax, whereas tax lawyers do not agree whether there is a similar exemption for gifts to 501(c)(4)s. Section 527 organizations can exist for the sole purpose of influencing federal elections, whereas 501(c) organizations must show some other non-political principal purpose. There is not an IRS approval process for creation of a 527, while 501(c)(3) and (c)(4) organizations can take months—or years—seeking approval. If the IRS thinks a 501(c) applicant is “too political” it will deny the application. All of these constitute good reasons for persons or groups seeking to engage in undisclosed political speech to choose the Section 527 form.

The problem, of course, is that all of these perceived advantages are the consequences of an unintended misconnection of federal tax and election laws. These laws were written by different Congressional committees, for different purposes, and are administered by different federal agencies with different administrative priorities. As a result, the existence of 527s engaged in candidate-related political activity but not registered and reporting anywhere as political committees is accidental, rather than the result of Congressional policy. Now that the results of this accidental chain of consequences is obvious to all, Congress has an opportunity to decide on an appropriate disclosure policy for these entities.

### *II. Section 501(c) Organizations*

Mr. Chairman, you have made it clear that you would like testimony on the inclusion of Section 501(c) organizations in any political disclosure system. While I am not a tax lawyer, I have had experience with a variety of 501(c) organizations from an election law perspective. Therefore, I will respond to your request to discuss in general terms these organization’s possible inclusion in a political communication disclosure system.

Since Section 501(c)(3) organizations are statutorily prohibited from intervening in federal elections, there would appear to be no reason to include their communications to the general public in such a disclosure system. Section 501(c)(4), (5), and (6) organizations (social welfare, labor unions, and trade associations) however, are all permitted by their tax status to engage in candidate-specific political communica-

tions, and many do so during the course of elections. It seems reasonable to require them to identify their larger expenditures for public communications, and to require that their names appear on the communications so that voters know the organizational source of the public communications.

The more difficult question is whether such organizations should be required to identify the names of some or all of their donors who have financed such public communications. The difficulty arises because by definition these organizations' principle purpose is not to conduct election activities (or they would qualify under Section 527, not 501(c)), and therefore they may have many donors who are not intending to engage in political speech. Further, since the organizations principle purpose may be focused on issues of a controversial and perhaps unpopular nature, there is a real risk to chilling these organizations and the contributions they receive from supporters if any disclosure system is not carefully thought out and hedged with safeguards. Such chilling would, of course, have serious constitutional implications.

For these reasons, I would urge the Committee to narrowly tailor any disclosure by 501(c)s. One such approach is to allow effected 501(c) groups to establish separate accounts which would pay for political advertising, and the contributors to which would be disclosed (as opposed to the contributors to the parent organization). This approach, commonly called Snowe Jeffords after legislation which passed the Senate in the last Congress, may be useful to this committee.

Another approach would be to except entirely or largely from donor disclosure those organizations so large and publicly supported that their names alone convey sufficient information about the message and interests of their funders. The Sierra Club and the National Rifle Association in the issue sphere, along with the Chamber of Commerce and the AFL-CIO in the business and labor sphere, come to mind in this regard: the general public understands the perspective they bring to the election contest, and their names alone should provide voters with sufficient disclosure of the interests they represent. The same cannot be said for new and/or unknown organizations, sometimes used only as vehicles for candidate specific political advertising paid for by a handful of anonymous donors. In these instances, major donor identification may be the only way for voters to know whose interests are represented by the generically named entity paying for the advertising.

Finally, it would certainly be appropriate for this Committee to adopt a higher threshold for donor disclosure for 501(c) organizations than for 527 entities. The FEC standard of \$200 and up, applicable to contributors to political organizations, may be far easier to transfer to 527 political entities than to 501(c) predominantly non-political groups. For the latter, a threshold based on substantial contributions (as measured either in absolute dollar terms or as a percentage of an organizations funding) would be appropriate, and constitutionally helpful as discussed below.

### *III. For-Profit and Not-for-Profit Entities without Tax Exempt Status*

Another type of legal entity the Committee needs to address is organizations that are incorporated as for profit or not for profit entities under state law, but which have not sought favored tax status under Section 527 or 501(c). Under state law such entities may engage in political communications to the general public. Under current FEC law such entities may not need to register or report if they do not engage in "express advocacy," so they will have no disclosure requirements. If they have no profits at the end of the tax year, because they have spent all of their funds for political advertising, then they will incur no federal income tax liability. Thus, in all material respects, they are as a matter of practice materially indistinguishable from Section 527 organizations in terms of their attractiveness as a vehicle for non-disclosed candidate specific election speech.

Recognizing that this Committee has jurisdiction over tax, not FEC, legislation, I urge you to consider whether it would be possible, and advisable, to condition such entities' tax treatment on their disclosure—or nondisclosure—of the sources of funding for their political advertising. For instance, Congress has already provided that expenditures for political activities by a corporation are not deductible as business expenses. Section 162e. Would it be possible for the tax code to encourage disclosure of political activities by non-527 and non-501(c) corporate entities by providing that if they engage in the same sort of narrowly defined political advertising as these tax exempt entities, and fail to disclose their major funders, then the funds used would be tax disadvantaged?

One possible approach might be to subject the funds transferred to the corporation to pay for the non-disclosed advertising to the federal gift tax? Alternatively, the funds used for such non-disclosed advertising could be denied treatment as a capital contribution to the corporation, and instead considered income subject to tax (and without any offsetting business deductions because it is political activity). Such a provision could be narrowly drawn to apply only to corporations whose principle ac-



tivity is political advertising, so as not to include entities which have true commercial reasons for existence. I do not recommend any particular solution to this issue, but merely seek to draw it to the Committee's attention. In my view, some treatment of this issue under the tax code will be necessary in order to accomplish the Committee's disclosure objectives.

Whatever approach to any of these entities is eventually adopted by the Committee, it is essential that the disclosure requirements be carefully drafted to take into account the Supreme Court's previously stated views on the permissibility of disclosure. It is to these holdings that my testimony will now turn.

#### *IV. The Supreme Court's Disclosure Jurisprudence: Buckley v. Valeo and Other Cases*

As a basic matter of constitutional law, the Supreme Court has allowed disclosure of candidate-related communications—and their funders—so long as the disclosure requirement is narrowly tailored (precisely drafted) to meet a compelling public interest. In the case of candidate-specific public political communications, the Court has on several occasions forcefully stated that a public interest in such disclosure exists. Therefore, what remains for Congress is to ensure that the disclosure requirement is narrowly-tailored. It must be (1) clear, not vague; (2) as minimally burdensome as necessary to accomplish the needed disclosure; and (3) provide exceptions where compelled by Supreme Court jurisprudence. If these three goals are met, the Court's cases indicate the disclosure will be upheld as constitutional. When the Congress last attempted to provide for full disclosure of money spent in federal elections in 1974, it failed to meet these tests. Now, this Committee, and Congress, has another opportunity to get it right.

##### *A. The Buckley Case*

In *Buckley v. Valeo*, the Supreme Court held the government's interests in disclosure sufficiently important to outweigh the possibility of infringement of First Amendment rights to anonymity of political speech, particularly where the "free functioning of our national institutions" is involved. *Id.* at 424 US 1, 66.

In reviewing the Federal Election Campaign Act 1971's post-Watergate amendments, the Court held that Congress had identified *three* compelling governmental interests for disclosure. The *Buckley* opinion stated that these were:

(1) Providing the electorate with information in order for the electorate to evaluate those seeking federal office. Disclosure allows voters to place each candidate on the political spectrum more precisely than is often possible solely on the basis of party labels and campaign speeches.

(2) Deterring actual corruption. "A public armed with information about a candidate's most generous supporters is better able to detect any post-election special favors that may be given in return." *Id.*

(3) Deterring and detecting violations. Public access to recordkeeping and disclosure helps to detect violations of contribution limits. Such violations would include in-kind contributions to candidates through candidate control and coordination of the group's activities.

*Buckley* at 67–68.

The Supreme Court observed in *Buckley* that Congress in the 1974 amendments sought "total disclosure" of federal campaign spending "reaching every kind of activity." The purpose of this broad disclosure was to ensure that political spending did not occur undisclosed merely because it was by groups that did not qualify as political committees. The Court stated that "in an effort to be all-inclusive, however, the provision raises serious problems of vagueness" because the disclosure requirement applies to "every person who makes contributions or expenditures," and those terms are defined as money spent "for the purpose of influencing a federal election." *Id.* at 77.

The Court noted that violations of the disclosure provisions carried a potential criminal penalty, and that it was a constitutional requirement that persons subject to criminal penalties must have adequate notice of the legal standard to which they are being held. How could someone know whether their contemplated conduct was illegal, the Court asked, when it was described by such a subjective terms as "for the purpose of influencing." Therefore, the Court held that standard to be overly vague, and in order to save the provision the Court rewrote it to apply only to speech that "expressly advocates the election or defeat of a federal candidate." *Id.* at 77–82.

In doing so, the Court made an assumption that has not been borne out by the last 25 years of practice. The Court stated that if the speech was by an entity under the control of a candidate, or whose major purpose was the nomination or election of a candidate, then the expenditures "can be assumed to fall within the core area

sought to be addressed by Congress. They are, by definition, campaign related.” *Id.* at 79. In fact, the FEC has not enforced the statute to cover activities by all entities “under the control” of federal candidates, and has not urged the courts (e.g. in the GOPAC case) to do so. Further, the Supreme Court in *Buckley* assumed that any spending coordinated with a candidate would be considered an in-kind contribution to the candidate, and therefore reportable. In practice, that has proved a far easier proposition to announce than to enforce. It is very difficult for the FEC to identify and investigate incidents of coordination because of their very surreptitious nature, and the courts have overturned FEC attempts to enforce this concept through prophylactic regulation. As a result, much spending that the Court in *Buckley* assumed would be covered by the federal disclosure laws, because of the involvement of federal candidates, is in fact beyond the current disclosure provisions.

Thus, the current state of disclosure law, brought about by Congress’s use of an overly vague term—“for the purpose of influencing”—and by the Supreme Court’s resulting rewriting of the statute, is contrary to what both Congress and the Supreme Court intended. Congress sought full disclosure of candidate-related election spending, and the Court thought its rewriting of the statute ensured disclosure of “spending that is unambiguously related to the campaign of a political candidate.”

The *Buckley* Court explicitly validated the informational interests that disclosure provisions serve, beyond the prevention of corruption rationale. Disclosure of the sources of funding of political speech, the Court said, sheds “the light of publicity on spending that is unambiguously campaign related but would not otherwise be reported because it takes the form of independent expenditures or of contributions to an individual or group not itself required to report the names of its contributors a disclosure helps voters to define more of the candidates constituencies.” *Id.* at 81.

Opponents of disclosure frequently cite the Supreme Court’s decision in *McIntyre v. Ohio Elections Comm’n*, 514 U.S. 334 (1995) for the proposition that disclosure is less favored by today’s Court than it was in 1976 when the *Buckley* decision was issued. What such persons fail to note is that *McIntyre* did not involve communications that either mentioned candidates or were disseminated as mass communications such as through the broadcast medium. Instead, the leaflets in *McIntyre* were handed out by one individual, at minimal cost, and involved only a local tax initiative. The Court in *McIntyre* explicitly noted the lack of candidate-related content and the fact that the communication was not distributed through the broadcast media.

Similarly, a number of lower courts have (correctly) interpreted *Buckley* as establishing an express advocacy test for disclosure. See *Vermont Right to Life Committee, Inc. v. Sorrell*, Second Circuit, June 15, 2000, *Virginia Soc’y for Human Life*, 83 F. Supp. 2d 668 (2000). However, these cases do not stand for the proposition that Congress is prohibited from requiring better but narrowly tailored disclosure. Rather, those cases adhere to the statutory standard the Supreme Court created in lieu of Congress’s vague “for the purpose of influencing” language. If Congress creates new disclosure language, and that new standard is upheld by the Supreme Court, then the new statutory test would be applied by the lower courts, instead of the *Buckley* test. It is exactly for this reason that the precise language of a new disclosure standard for candidate specific election advertising is so important.

#### B. “Narrowly Tailored”

It is precisely this disclosure interest which your Committee is addressing today. Congress’s task is therefore to narrowly tailor any new legislation so that it meets this governmental interest in disclosure, recognized by the Supreme Court, in a form that is neither vague (as in *Buckley*) nor overly broad. In several cases, both before and after *Buckley*, the Court has provided a road map of the sorts of disclosure provisions Congress should write. These may be summarized, briefly, as follows:

(1) Clearly delineating the speech covered, rather than using vague and confusing terms (*Buckley*);

(2) Providing an exemption from disclosure for those persons who would face a “serious threat of reprisal” if their participation were public (*NAACP v. Alabama, Socialist Workers Party*);

(3) Limiting disclosure to major funders, either using a dollar minimum, or a percentage of the organizations total budget. This is clearly preferable to disclosure of all members or contributors (*NAACP*) and is the standard already used for filing Form 990s;

(4) Limiting the disclosure in time, to speech in those periods close to the elections (see, by contrast, *McIntyre*);

(5) Limit disclosure to communications broadly communicated to the general public, perhaps only through mass media and mailings, or with a significant expenditure threshold (see, by contrast, *McIntyre*);

(6) Make the disclosure process administratively easy, so it is not unduly burdensome on the reporting entity (see, by contrast, *Massachusetts Citizens for Life*);

(7) Provide an exemption for reporting by the news media, as the Federal Election Campaign Act does.

#### V. CONCLUSION

It is possible for Congress to require additional disclosure of candidate-specific election advertisements. Congress has legitimate purposes in doing so that have been explicitly approved by the Supreme Court in *Buckley*. However, in reaching such speech for disclosure purposes, Congress must be careful to design the disclosure system so that it is clear, not vague, and precisely drafted to achieve its purposes. The criteria I have just outlined should provide a road map for such drafting.

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Mr. PORTMAN. Ms. Mitchell.

#### STATEMENT OF CLETA DEATHERAGE MITCHELL, ATTORNEY, SULLIVAN & MITCHELL, P.L.L.C.

Ms. MITCHELL. Thank you, Mr. Chairman. My name is Cleta Mitchell. I am a practicing attorney here in Washington, D.C., a partner in the law firm of Sullivan and Mitchell. We specialize in the area of campaign finance and election law at the State and Federal levels, and represent candidates, candidate Committees, individuals and corporations, both for-profit and not-for-profit, who are involved in various aspects of the political and public policy arenas.

I would like to submit to you, Mr. Chairman, that this is a classic example of legislation by headline, that for the past year what we have seen are articles with pejorative terms about shadowy, secretive, stealth organizations; and it is important I think that we take a moment—I appreciate the fact that somebody at least in this Congress is willing to have a hearing on this matter before enacting legislation which implicates basic First amendment rights of the citizenry.

And I know it is not very politically popular or politically correct to say this, but the fact is, journalists are not the only ones with First amendment rights, and it is very important to think about the First amendment implications of all of these proposals. The freedom of speech, the freedom of association, and the right to petition the government. These are all very significant rights that are implicated in every proposal that is currently pending on this subject.

Now, First amendment law requires that Congress, before enacting legislation that implicates First amendment rights, must first identify the problem it seeks to correct and then narrowly tailor a solution to remedy that problem. So I would suggest that the very first order of business is for Congress to identify what is the problem and what is the origin of the problem.

The IRS really created this situation by broadening the list of exempt purpose expenditures to include for section 527 Committees, such things as voter registration, issue advocacy, voter registration, and so forth. If Congress wants to identify that as the problem, that 527 Committees are not being utilized for the purpose for

which they were originally intended, it would be my suggestion that Congress can do one of two things or both.

Congress could say all 527 Committees shall file a 990 tax return just like other tax-exempt groups. Rather than creating a whole new regime of disclosure and filing and regulation, Congress would say we are going to treat all tax-exempt groups alike, you all will file a 990.

Congress could also well decide that a 527 Committee should only be for the purposes originally intended related to candidates or political parties. But if Congress should do that, then the Internal Revenue Service should also be required to reconsider its decisions to deny tax-exempt status as 501(c)(4)s to the National Policy Forum and to the Christian Coalition.

It seems to me that what the IRS has done through its decision-making process the last several years is to move groups away from 501(c)(4) status into the 527 arena, and it seems to me that that is something that Congress ought to address.

Second, it seems that really, this is *not* what is at issue here. If you look at the statement, the opening statement, of the Treasury Tax Legislative Counsel, Mr. Mikrut, he just said what I think is really going on here. "The administration strongly supports efforts to require greater disclosure of political campaign contributions and expenditures as part of its ongoing efforts to achieve comprehensive campaign finance reform."

What we are doing here, what we are seeing here is an effort to do an end run around existing campaign finance laws and the rule of law established by the Supreme Court in *Buckley v. Valeo*. That is it pure and simple.

I have to tell you that sitting here a moment ago, listening to the tax counsel and the Joint Committee's counsel try to answer your questions, Mr. Portman, about whether this ad would be considered political or whether that one would be—and let me just point out what the answers were that, well, we use the facts-and-issues test or the on-balance view.

The fact of the matter is, the Supreme Court specifically said that citizens have a right to know in advance what speech is going to be subject to regulation by the government and what is not and that, in fact, the defining line between issue speech and candidate speech may be difficult to tell; but the citizens have to have a bright line, and they have to know.

This Committee must abide by the First amendment requirements of *Buckley v. Valeo* and not seek to create in the Internal Revenue Service, for God's sake, the opportunity to regulate the political speech of Americans. That is a frightening prospect. I would recommend that if we do anything, that this Committee enforce existing law in two respects.

Number one, if the 990 political expenditure categories are not being addressed or properly reported, deal with those. Make everybody file one and make that process work.

And number two, I have listed in my testimony five pages of evidence where the 501(c)(5) labor unions are not complying with existing reporting requirements regarding their political activities—\$13 billion unaccounted for in the 1996 cycle, \$20.5 million unac-

counted for in the 1998 cycle, and \$35 million unaccounted for in this cycle.

Now, it seems to me that before Congress enacts some comprehensive new regulatory regime, vesting in the Internal Revenue Service to regulate our First amendment rights, that the first thing Congress ought to do is enforce the existing laws. Thank you.

Mr. PORTMAN. Thank you, Ms. Mitchell.

[The prepared statement follows:]

**Statement of Cleta Deatherage Mitchell, Attorney, Sullivan & Mitchell,  
P.L.L.C.**

Mr. Chairman, Members of the Committee:

My name is Cleta Mitchell. I am a practicing attorney in Washington, D.C., a partner in the law firm of Sullivan & Mitchell P.L.L.C. Our firm specializes in the area of campaign finance and election law at the state and federal levels. We represent candidates, candidate committees, individuals and corporations, both for profit and not-for-profit, who are involved in the political and public policy arenas.

The issue of 'disclosure' of income to and expenditures by IRC § 527 committees has become, with all due respect, a classic example of legislation by headline.

I have spent countless hours over the past year discussing this issue with members of the press and it is clear that there is a basic lack of knowledge on this subject by those who are most adamant about it. So, let me begin this testimony with a primer, mainly for the reporters in the room, but for the members of Congress as well.

The media having determined that legislation is needed and having demanded action, it seems only reasonable that we ought to try and interject some knowledge of the subject in hopes that the reporters who are driving this legislation can become informed about this matter upon which they have weighed in with such vehemence.

For that reason, I have attached a chart which we use in our office to describe for clients the differences between and among various types of tax-exempt entities through which citizens may wish to become involved in the legislative, public policy or political arena(s).

I would note that there are 25 sections of IRC § 501c which describe and define various types of non-profit, tax-exempt entities. Those reflected on the chart are the ones pertinent to today's discussions.

**CHART #1: TABLE OF TAX EXEMPT ENTITIES AND PERMISSIBLE ACTIVITIES**

I submit that the reason § 527 committees have become more significant over the past five years is NOT because some group of donors have sought to hide anything -but rather because the Internal Revenue Service has seemed intent upon denying to certain groups c4 status.

Remember the National Policy Forum?

Remember the Christian Coalition?

In both instances, the IRS denied the groups' c4 status applications on the basis that the groups were 'partisan' and thus, were more appropriately § 527 committees, even though the groups were involved in issues and voter education, and were never candidate campaign committees.

These recent IRS decisions are not consistent with its earlier decisions. For example, the Democratic Leadership Council is a 501c4 social welfare organization, which is clearly partisan, so why did the IRS deny the National Policy Forum and the Christian Coalition similar status?

My point here is that contrary to news reports over the past year, there is nothing 'sinister' or 'evil' or 'corrupt' or 'shady' about issue organizations operating as § 527 committees. In my opinion having reviewed various private letter rulings from the IRS, it is entirely appropriate for organizations and citizens groups who are interested in voter registration, voter education and issue advocacy to be constituted as § 527 committees based on recent decisions of the IRS.

My recommendation to the Committee as you consider this subject and the various proposals before you is that you be guided by four basic principles and recommendations:

First, treat all tax exempt entities alike. Do not pick winners and losers, don't create separate types of reporting and filing and disclosures for different types of entities depending on the media's mood this year. Treat all alike.

Second, the most pressing need for disclosure of political expenditures is to those who are members of tax-exempt organizations and whose dues and/or assessments are paying for the political expenditures. Before you embark on a massive public disclosure regimen, begin with requiring tax-exempt organizations to disclose to their members the amount of their dues and assessments devoted to political activities.

Third, demand and ensure enforcement of and compliance with existing disclosure laws before you create new ones.

Fourth, remember the Constitution. You have all sworn to uphold the Constitution. There are significant First Amendment considerations and concerns which simply cannot and must not be ignored, notwithstanding the fact that adherence to such principles is politically incorrect these days.

Let me amplify each of these.

#### I. TREAT ALL TAX EXEMPT ENTITIES ALIKE BY REQUIRING COMMON TAX FILINGS: THE 990 TAX RETURN.

There is only difference between a § 527 committee and every other tax exempt entity on the chart, and that is that § 527 committees file a different type of tax return than other tax-exempt organizations.

If Congress wants to treat § 527 issue committees like the others, then Congress should pass a bill requiring § 527 committees to file a 990 tax return and make them subject to the same disclosures as the other types of tax exempt entities.

And rather than starting from the presumption that YOUR § 527 committees, your principal authorized campaign committees and national party committees, should be exempt from these new filing requirements you are considering, you should instead START with the presumption that your § 527 committees and all other § 527 committees should file the same tax returns that other non-profits do and those should be available to the public on the same basis as other 990s. You should exempt NO § 527 committee from these requirements and all non-profits will instantly be on the same level of disclosure for all purposes related to their legal structure.

Does it matter? Yes. I'll give you one example.

The Democratic Congressional Campaign Committee (DCCC) is a § 527 committee, which reports its contributions and expenditures to the FEC. The DCCC's reports are, in my opinion, difficult and complicated. But one of the more curious items on the DCCC's reports of contributions to its non-federal account is a notation at the top of each page, which reads: "Receipts include Direct Contributions AND Harriman Communications Center Revenue." What does that mean? In reviewing the various entries, odd numbers appear, most of which are from communications or media entities, such as Joe Slade White Communications, Doak, Shrum, and Devine and other Democratic media consultants.

What is that notation "Harriman Communications Center Revenue"? Why is that revenue lumped together with "Direct Contributions"? Is that revenue accounted for in its tax returns or isn't it?

We don't know because the DCCC's 1120 POLs, its tax returns, are not publicly disclosed.

Why shouldn't the tax returns for the DCCC be a matter of public record so we could see what that income from the Harriman Communications Center actually is and what offsetting expenses exist?

That information is not available from existing FEC reports. If the DCCC were required to file a 990 and make it available as other non-profit entities do, we could follow that money and perhaps, and know what the revenue sources are and what the expenses are and for what.

Why are Democratic media consultants using the DCCC's communications center? Are they being charged a reasonable market rate for its use? Are the consultants using the Harriman Center for federal candidates at less than full market costs?

This reporting method raises a great many questions -and the media AND Congress should be as determined in getting THAT information as reporters have been on the subject of other § 527 committees.

By requiring the DCCC and every other § 527 committee to file a 990, all tax exempt entities will operate on the same basis.

## II. REQUIRE DISCLOSURE TO MEMBERS OF TAX EXEMPT ORGANIZATIONS OF THE AMOUNT OF DUES AND ASSESSMENTS USED BY THE ORGANIZATION FOR POLITICAL EXPENDITURES.

The other glaring difference in and among the tax-exempt entities on the chart is very simple: all but one of the entities on the chart receive funds from sources, whether individuals or other entities, which voluntarily make the decision to either join or contribute.

However, the 501c5s which are labor organizations, the unions, are not comprised of members all of whom voluntarily decide to join. In the case of the labor unions, not only do we not know who the donors are to their political activities, but the donors *themselves* do not know who they are. Those who are paying for the labor unions' political activities are not even aware because that information is not disclosed by the unions to its members.

This is morally wrong and it is imperative that Congress remedy this situation. Congress should require that tax exempt entities notify their members annually with the following disclosures:

- a) the amount received by the organization from that individual for dues and assessments
- b) the amount of each member's dues and/or assessments spent by the organization for political expenditures, and the breakdown by political party of the organization's political expenditures
- c) notice of the right of the member to receive a refund from the entity for the amount of the political expenditures from dues and/or assessments

If it's disclosure you want, then you should start by requiring that tax-exempt organizations, including the labor unions, disclose to their own members exactly how much of their individual dues and assessments have been utilized for political purposes and for which political parties and a notice that the member has a right to receive a refund.

Before you institute a new, burdensome and intrusive reporting and public disclosure regimen for political expenditures by tax exempt groups, start with a simple requirement that people paying for political activities have a right to know they're doing so.

## III. DEMAND ENFORCEMENT OF AND COMPLIANCE WITH EXISTING REPORTING AND DISCLOSURE LAWS.

The media and Congress seem bent upon enacting new laws for disclosure of political expenditures. Before doing that, it might make some sense to be similarly dedicated to enforcement of existing laws on this subject.

Since this legislation and, indeed this hearing surrounding § 527 committees is a byproduct of news stories, you won't mind if I rely on various news reports.

In 1995, the labor unions announced their intent to spend \$35 million in the 1996 cycle. Gerald McEntee, President of AFSCME and Chairman of the AFL-CIO Political Action Committee, appeared on McNeil/Lehr on April 6, 1996, to discuss labor's plans. This excerpt from the transcript:

"The AFL-CIO has, among other things, targeted for defeat many of the 73 freshman Republican House members elected two years ago and will spend \$35 million to get it done.

JIM LEHRER: What's this money going to be spent doing?

MR. McENTEE: Well, not—you know, I think it's important to note that not one dime will go to a particular candidate, nor to a particular party. We're going to try and get people out to vote, and then we're going to run some television ads and some radio ads, and we'll get pamphlets and information out to working America about the records of the members of Congress."

Now, it is true that there are no current reporting requirements for issue advertising under the campaign finance laws or for grassroots lobbying on legislation which is exempt from the reporting and disclosure requirements of the Lobbying Disclosure Act of 1995.

However, that is NOT true for the other types of expenditures Mr. McEntee referenced in that interview with Jim Lehrer.

Current federal campaign finance laws allow expenditures by corporations and labor unions in support of or opposition to federal candidates, so long as those expenditures are directed ONLY to members of the union or the restricted class of the corporation as defined by the FEC. All such expenditures over \$2,000 are required by law to be reported quarterly to the FEC, noting which candidates are being supported or opposed.

Further, the FEC has very specific regulations governing the use of labor union funds for activities associated with member mobilization in elections, and for communications beyond union members for voter registration, development and production of voter guides and voting records and for other communications beyond its members.

So, are unions complying with existing law? You tell me.

In the September 4, 1999 issue of National Journal, in an article entitled "Labor's Political Muscle" by Kirk Victor and Eliza Newlin Carney, the following paragraph appeared:

"Although the AFL-CIO was dismissed as irrelevant in 1994, when Republicans seized control of Congress. . . it rebounded in 1996 with a \$35 million political mobilization campaign. The largest share of that money -some \$15 million, according to AFL-CIO officials—went to high profile television advertisements that promoted policy issues, not candidates, and thus escaped federal regulation."

What the story doesn't say because NOBODY apparently bothered to ask is 'what about the other \$20 million?

According to the FEC reports, organized labor only reported spending \$2 million during the 1996 cycle. If, as Mr. McEntee promised on national television, it was spent on such things as voter registration, education and member mobilization, those expenditures ARE subject to federal regulation. Why is no one asking the labor unions where is the other \$20 million? Who is asking the unions those questions? No one, as near as I can tell.

Now look at the 1998 cycle:

The same National Journal article, September, 1999, reported:

"In 1998, Sweeney surprised his opponents by again switching strategies. He spent far less on issue advocacy and concentrated on a back-to-basics ground war that turned out union voters through phone banks, door-knocking, and direct mail. Less than \$5 million of the AFL-CIO's \$28 million political budget in 1998 went for issue ads."

From USA Today, October 14, 1999, it was reported:

" . . . in the 1998 elections, tens of thousands of union members and their families participated in sophisticated campaign operations that put a heavy emphasis on personal contact with voters. About 5.5 million telephone calls were made on behalf of political candidates to union families, urging them to vote."

Two days after the 1998 election, November 5, 1998, Donald Lambro wrote an article which appeared in the Washington Times, quoting a number of labor union operatives and associates who were ecstatic about the results of the November election. The headline:

"AFL-CIO's Election Day Effort Paid Off Big for Democrats"

" . . . labor quietly conducted a campaign that focused on voter registration, get-out-the-vote phone banks and knocking on doors on Election Day to turn out up to 13 million union members. "In city after city, they put hundreds and hundreds of people into the field," said Democratic campaign strategist Vic Kamber. The effort, costing almost \$20 million, was directed by hundreds of AFL-CIO field coordinators, who worked full time to mobilize tens of thousands of union workers on behalf of Democratic candidates."

Really?

So what did the AFL-CIO report spending in 1998 for those member mobilization efforts described in the National Journal, USA Today and the Washington Times? That twenty million dollar effort was reported by the AFL-CIO to the Federal Election Commission as a \$2.5 million expenditure.

Where is the other \$17.5 million?

How about this quote from Vic Kamber in the Washington Times story?

"In Las Vegas they had 120 paid shop stewards working the polling places.

And that kind of effort paid off for them."

The AFL-CIO reported to the FEC that it spent only \$17,792 in 'on the ground' activities supporting Shelley Barkley and \$28,000 on behalf of Sen. Harry Reid in Nevada. Assuming that all of the AFL-CIO's expenditures for Harry Reid were in Las Vegas, that still brings the grand total spent by the AFL-CIO in Las Vegas to only \$46,000.00.

Those news reports raise very serious questions about the use of the AFL-CIO's funds and the failure of the AFL-CIO to account for all its political expenditures, as required by existing law.



Were those '120 paid shop stewards' paid by the unions? Were they communicating with the general public at the polling places?

If so, not only was it not reported, it was illegal.

Another possible irregularity reported in that same Washington Times story:

"Labor union allies said the AFL-CIO also poured large amounts of money into efforts to boost black and Hispanic turnout, including sending the Rev. Jesse Jackson around the country to encourage higher turnout among minorities."

Were any of Jesse Jackson's appearances coordinated with any candidates? Who attended those events? Who paid for the events? Did any congressional candidates appear with Rev. Jackson at events paid for by the AFL-CIO?

If so, such expenditures of labor union funds by the AFL-CIO was illegal and is specifically prohibited by existing campaign finance laws.

Now, what about the current cycle?

According to that same National Journal article, the AFL-CIO has pledged to spend \$46 million on political activity and will 'keep the focus on the ground war'.

A *Washington Post* story by Frank Swoboda appearing on Thursday, February 18, 1999, quoted Gerald McEntee, Chairman of the AFL-CIO political committee as saying labor would "keep (its) people mobilized and engaged for the year 2000."

"McEntee said approximately three-fourths of the money will be spent on field operations, such as issue education and get-out-the-vote efforts, and the balance on media campaigns. He said this was about the same ratio as the 1998 election spending and a reversal of the spending ratio in 1996, when the federation raised \$35 million for a one-year effort."

By my calculations, the member mobilization program will cost approximately \$36 million during this cycle.

And what has the AFL-CIO reported to the FEC spending on this program through the first year of its two year effort?

As of March 31, the AFL-CIO has reported to the FEC expenditures of only approximately \$900,000.

*My question is:*

Why are the unions ignoring the existing regulations and reporting laws? Why is no one insisting that the unions comply with the laws? And why is Congress considering enacting NEW filing and disclosure laws when the current laws are not being enforced?

Finally, one other VERY interesting item in that same Washington Post story:

"Although AFL-CIO officials would not give an official estimate of the size of the new two-year budget for its political operations, officials familiar with the spending plan said it would be roughly double the \$21.5 the federation spent in the 1998 elections. Approximately \$14 million a year would come from an extension of the voluntary 'Buck a Member' campaign that federation leaders approved last year for the 1998 midterm congressional elections and another \$7.5 million would come from the annual increase in political spending approved at the federation's last convention. The balance would come from 'other sources within the federation,' officials said."

We are back to an earlier point. The sources of funding for the AFL-CIO's political activities are NOT known, and not disclosed, not to the public and not even to the dues paying members of the unions who are footing part of the bill. But that is, apparently, only part of the costs of the unions' political program. The numbers just don't add up.

Evidently, there are sources -secret sources—beyond the dues paying members of the unions who are financing the unions' political activities. Who are they? How much are they paying?

Those 'other sources within the federation' will come up with more than twenty million dollars for the unions activities this cycle.

The *Washington Post* headline on the story by Ruth Marcus on Monday, May 15, 2000, about § 527 committees read: "Flood of Secret Money Erodes Election Limits"

There was no mention of the 'other sources' of the unions' \$20 million for this election cycle.

Doesn't that \$20 million count as a 'flood of money'?

Doesn't anyone in the media want to know where THAT money is coming from? Doesn't anyone want to know how it is being spent and whether it is being spent for legal or illegal purposes?

Until there is enforcement of the existing laws, don't just scurry around creating new ones.

I've attached a chart with a recap of the amounts I've just outlined.

#### CHART #2:—AFL—CIO POLITICAL EXPENDITURES 1995-PRESENT

#### IV. Remember the Constitution.

Finally, while it is not politically correct these days to remind Congress that citizens have First Amendment rights to engage in political speech and activities without government interference, regulation, control or disclosure, it is imperative that you take at least a moment to consider the First Amendment principles which impact this subject.

There are three important decisions of the United States Supreme Court which are, I believe, essential for Congress to be study and apply to the consideration and enactment of any legislation on this subject.

Those cases involve guaranteed First Amendment rights of citizens to do the following:

- voluntarily associate with other like-minded persons in private organizations without having to disclose that association to the government
- anonymously disseminate their views on political issues, including issues at election time
- know in advance what speech is going to be subject to government regulation and which speech is not subject to government regulation

#### THE RIGHT TO VOLUNTARILY ASSOCIATE WITH OTHER LIKE-MINDED PERSONS IN PRIVATE ORGANIZATIONS WITHOUT HAVING TO DISCLOSE THAT ASSOCIATION TO THE GOVERNMENT.

In *NAACP v Alabama*, 78 S.Ct. 1163 (1958), the Supreme Court invalidated an effort by the State of Alabama to requiring a non-profit organizations to turn over documents, records, bank account and other organizational information, including its membership lists to the government, saying:

“Effective advocacy of both public and private points of view, particularly controversial ones, is undeniably enhanced by group association, as this Court has more than once recognized by remarking upon the close nexus between the freedoms of speech and assembly”. . . it is immaterial whether the beliefs sought to be advanced by association pertain to political, economic, religious or cultural matters, and state action which may have the effect of curtailing the freedom to associate is subject to the closest scrutiny. “It is hardly a novel perception that compelled disclosure of affiliation with groups engaged in advocacy may constitute a(n) effective restraint on freedom of association . . . the Court has recognized the vital relationship between freedom to associate and privacy in one’s associations. . . Compelled disclosure of membership in an organization engaged in advocacy of particular beliefs is of the same order. Inviolability of privacy in group association may in many circumstances be indispensable to preservation of freedom of association, particularly where a group espouses dissident beliefs. (citations omitted)” 78 S. Ct. @ 1171–1172

#### THE RIGHT TO ANONYMOUSLY DISSEMINATE VIEWS ON POLITICAL ISSUES, INCLUDING ISSUES AT ELECTION TIME

In *McIntyre v. Ohio Elections Commission*, 514 U.S. 334 (1995), the Supreme Court invalidated an Ohio election regulation which banned anonymous campaign literature, saying:

“Under our Constitution, anonymous pamphleteering is not a pernicious, fraudulent practice, but an honorable tradition of advocacy and of dissent. Anonymity is a shield from the tyranny of the majority. It thus exemplifies the purpose behind the Bill of Rights, and of the First Amendment in particular: to protect unpopular individuals from retaliation—and their ideas from suppression—at the hand of an intolerant society. The right to remain anonymous may be abused when it shields fraudulent conduct. But political speech by its nature will sometimes have unpalatable consequences, and, in general, our society accords greater weight to the value of free speech than to the dangers of its misuse.” 514 U.S. @ \_\_\_\_\_.

THE RIGHT TO KNOW IN ADVANCE WHAT SPEECH IS GOING TO BE SUBJECT TO GOVERNMENT REGULATION AND WHICH SPEECH IS NOT SUBJECT TO GOVERNMENT REGULATION.

There is an ongoing, simmering outrage among many in this city that the Supreme Court in *Buckley v. Valeo*, 424 U.S. 1 (1976), decided twenty-five years ago that Congress cannot regulate all forms of political speech. But it did. The Supreme Court specifically upheld the right of citizens to engage in issue speech that is NOT subject to government disclosure, interference or limitation. Further, the Supreme Court defined exactly what speech is subject to government regulation: that is, speech which expressly advocates the election or defeat of a clearly identified federal candidate. Period. And that is at the root of today's hearing—the fact that many, many in this town want to overturn or circumvent the Court's decision in *Buckley*. Was it an unintended consequence that issue advocacy and express advocacy speech are nearly indistinguishable? No. It was acknowledged specifically by the Supreme Court:

“(T)he distinction between discussion of issues and candidates and advocacy of election or defeat of candidates may often dissolve in practical application. Candidates, especially incumbents, are intimately tied to public issues involving legislative proposals and governmental actions. Not only do candidates campaign on the basis of their positions on various public issues, but campaigns themselves generate issues of public interest. Citing *Thomas v. Collins*, 323 U.S. 516 (1945), this Court observed:

“[W]hether words intended and designed to fall short of invitation would miss that mark is a question both of intent and of effect. No speaker, in such circumstances, safely could assume that anything he might say upon the general subject would not be understood by some as an invitation. In short, the supposedly clear-cut distinction between discussion, laudation, general advocacy, and solicitation puts the speaker in these circumstances wholly at the mercy of the varied understanding of his hearers and consequently of whatever inference may be drawn as to his intent and meaning.

“Such a distinction offers no security for free discussion. In these conditions it blankets with uncertainty whatever may be said. It compels the speaker to hedge and trim.” (citations omitted) *Buckley*, 424 at 43.

Please. Remember the Constitution.

Don't be stampeded into enacting something that is ill-advised and which violates the citizens' rights to associate and to engage in political speech without disclosure and regulation by the government.

Thank you for the opportunity to appear before this Committee. I will be happy to answer any questions the Committee may have.

Chart #1:—Table of Tax Exempt Entities and Permissible Activities

IRS code section	Types of entities	IRS permissible activities	IRS prohibited activities	FEC regulation of political activities
§ 501c3 .....	Charities, educational institutions and foundations.	Charity, public education, limited grassroots lobbying.	Lobbying as a <b>substantial</b> portion of activities is prohibited; Campaign activities prohibited: loss of tax status & tax penalties.	IRS regulations govern c3's political activities
§ 501c4 .....	Social welfare; grassroots and other lobbying and/or issue membership organizations.	Public education on policy issues; direct lobbying; member mobilization for grassroots lobbying & campaign purposes.	Direct partisan political campaigning is prohibited, except to <b>members</b> only.	Must establish PAC for direct candidate contributions or express advocacy to public; Member mobilization permitted under FECA
§ 501c5 .....	Labor unions, horticultural & agricultural organizations.	Collective bargaining; public policy organizing; direct and grassroots lobbying; member mobilization for grassroots lobbying & campaign purposes Lobbying expenses not tax deductible.	Must establish PAC for direct candidate contributions or express advocacy to public; Member mobilization permitted under FECA.	
§ 501c6 .....	Business leagues, trade associations, chambers of commerce, etc..	Benefits to members engaged in similar business enterprises; public policy organizing; direct and grassroots lobbying; member mobilization for grassroots lobbying & campaign purposes Lobbying expenses not tax deductible.	Must establish PAC for direct candidate contributions or express advocacy to public; Member mobilization permitted under FECA.	
§ 527 .....	Political Committees .....	Political candidate committees; party committees; issue, voter education and advocacy committees.	IRS defines 'exempt purpose activities': may only engage in exempt purpose activities; must pay taxes if spent for non-exempt purposes.	If committee expressly advocates election or defeat of clearly identified federal candidate, & party committees subject to FECA; state laws apply to state political committees

Source: Sullivan & Mitchell P.L.L.C.

Chart #2:—AFL–CIO Political Expenditures 1995–Present

Election cycle	Amount claimed 1		Amount spent for issue ads 2	Amount reported to FEC 3	Amount not reported to FEC; not spent on issue ads
1995–96 .....	\$ 38 million .....	\$15 million .....	.....	\$ 2 million .....	\$13 million
1997–98 .....	\$ 28 million .....	\$ 5 million .....	.....	\$ 2.5 million .....	\$ 20.5 million
1999–2000 .....	\$ 46 million .....	\$10 million (4) .....	.....	\$ 900,000 (thru 3/31/ 00).	\$35.1 million

1 *National Journal*, September 4, 1999, “Labor’s Political Muscle,” by Kirk Victor and Eliza Newlin Carney, quoting AFL–CIO officials  
2 *ibid*  
3 Federal Election Commission, Communication Cost Index Reports for 1995–96, 1997–98, and 1999–2000 through March 31,2000.  
4 Estimates based on 'ratio' noted in *Washington Post*, February 18, 1999 “AFL–CIO Plots a Push for Democratic House; Union Allots \$46 Million for 2-Year Effort,” by Frank Swboda.

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Mr. PORTMAN. Professor Troy.

**STATEMENT OF LEO TROY, PROFESSOR OF ECONOMICS,  
RUTGERS UNIVERSITY, NEWARK, NEW JERSEY**

Mr. TROY. Thank you. I appreciate the invitation. The remarks I will make are my own.

I begin with the premise that unions are unions, and unions' campaign contributions. Unions are not only tax exempt, but they are the beneficiaries of very important public policies both in the private sector and in the public sector. I ask four questions.

To begin with, do unions fulfill their obligation of full disclosure not only to the public of whom they owe these benefits, but also their members? So I ask, to follow up on that, what is the extent of unions' political contributions? From the Federal Election Commission, we know they gave in the 1995-96 presidential cycle \$100 million, but that is only the tip of the iceberg. I have estimated, using what I call a political multiplier—it is a derivative of what Lord Keynes came up with in 1935 in trying to explain the movement of the economy that a new investment of, say, \$1 will multiply the amount—will multiply the amount of the increase in the gross domestic product.

Well, I use that analogy here. If the unions have spent \$100 million through their political action Committees in 1995-96, I estimated, through use of this political multiplier, that the value of their in-kind contributions, which are not addressed by anything I have heard here today—nor can they be, frankly.

I think it is self-defeating to think—apropos of some of the questions that Mr. Portman asked before about "gray areas," there is just no solution to these gray areas, that this \$300 million might sound like an outlandish figure until we consider what are the unions' resources.

Their income is about 14 billion. I want to make that number clear, 14 billion. In a 1995 estimate of their assets—that 14 billion is roughly a current value; in 1995 they had about 10 billion in assets.

What do I mean by these in-kind contributions? There are three basic categories:

One, services provided either by union members free of charge to anyone, employees of unions—and we don't know how many employees unions we have in this country. It would be fruitless to call the Labor Department; they don't know either. But there are 47,000 unions in this country, most of them local unions, about 45,000 local unions, a couple thousand intermediate bodies and under a hundred international organizations. They have 16 million members.

The in-kind contribution that comes from labor services, there is no way of evaluating. In fact, none of these in-kind contributions can be evaluated. We have to think of them from the standpoint of economics, which is, what is the alternative cost? What would it cost the beneficiary of all these activities? And I don't see any of the Democrats here, but it is the Democratic Party. The media

which the unions have—that is, periodicals, newspapers which are sent out every month to over 16 million members is a one-party press.

Now, we have to ask the question, does the union leadership, what I call “the management,” actually represent the will of the members. They say they do surveys and they are acting on those surveys. I have waited a long time to see the results; I want to call again for it today.

We have media still left in the room I believe. Why don’t they ask the leading unions of this country, not just the AFL–CIO, who don’t conduct those surveys, but affiliated unions, international unions like the Teamsters, how they conduct their surveys? Show us how you do it. What are your methods? When do you do it? What are the results? I have never seen any disclosure of that either.

The question then becomes, can unions sustain that level of in-kind contribution, which I have been arguing they do; and I return to the point that the financial assets, the financial income that they have enables them to do so.

I want to turn finally to another question and follow up with a conclusion. Does the Labor Department’s reporting firms, which superseded the 990, I believe, for unions, are they worth—are they valuable to learn what we are talking about; and the answer is clearly, in a word or less, no.

And I want to indicate how fruitless they can be. For example, the Household International Corp. signed an agreement with the AFL–CIO in 1995 in exchange for the right to print an AFL–CIO emblazoned credit card to be distributed to their members or made available to their members. They gave the AFL–CIO 375 million over the last 5 years. That is reported on the LM-two form, the reporting form at the Labor Department. It does not tell us where those funds were expended.

In conclusion, let me say this. I have no confidence, with all due respect to this Committee, with all due respect to the eminent Senators we heard here today, that any new legislation can deal with this in-kind contribution. I am advocating free markets in our political life. Free markets have served us well in the economy. We are the envy of the world for it, and we are now living in a new age of Adam Smith in terms of economics; and I think it is time to turn to that viewpoint in the political market. Thank you.

Mr. PORTMAN. Thank you, Mr. Troy.

[The statement of Mr. Troy follows:]

**Statement of Leo Troy, Professor of Economics, Rutgers University,  
Newark, New Jersey**

*1. Personal Information.*

I appear here on my own behalf; my views are not those of my University nor of any other organization, nor have received any fees or grants from any organization in connection with this appearance.<sup>1</sup>

<sup>1</sup> For nearly one-half century I have focused my research on unions, collective bargaining and labor markets. The results of my work have been published in all the major journals of industrial relations and by the National Bureau of Economic Research. These have dealt with major aspects of unionism including union finance, union philosophies and the differences between public and private sector labor in the U.S. and Canada. I pioneered the study of union finance, union philosophies, the distinction between public and private labor organization, and the devel-

Continued

2. *Unions' Political Contributions and Endorsement in Presidential Election Cycle Years.*

Unions' cash political contributions, which are reported to the Federal Elections Commission, will be dealt with here as they help determine the larger and almost universally ignored unions' in kind political contributions. By in kind contributions, I mean any services and publications paid for by unions or provided by volunteer labor services on behalf of political candidates and a political party. Virtually all of these are expended on behalf of candidates of the Democratic Party. The most valuable of these contributions are the union press, labor services, and the structure of the union movement itself.<sup>2</sup> For the presidential cycle year 1995–96, I estimated the value of unions' in kind contributions at \$300 million. (Refer to § 3 on my method of calculating the value of in kind contributions). Their cash contributions reported to the FEC in that cycle were about \$100 million, bringing the total to \$400 million.

The in kind contributions are made possible by unions' financial power. They receive a total income of about \$14 billion and hold assets in excess of \$10 billion. (Masters and Atkin, Table 1, *Industrial Relations*, Oct. 1997, p. 494, and data unreported to the Labor Department).<sup>3</sup>

The financial ability of unions to implement their in kind contributions is enhanced by the *structure* of the union movement. Contrary to popular and media notions, the union movement is not the AFL–CIO on 16th Street in Washington, D.C.; the Federation is the tip of the iceberg. The union movement consists of about 45 thousand local unions, some 2 thousand or so intermediate bodies distributed across the country, and under 100 large national and international headquarter bodies, many of which are located in the District. Unions' total income is nearly evenly divided among the 45 thousand local unions and their parent bodies. Locals control about 47 percent of unions' total revenue and assets, while the parent unions' share account for 40 percent of revenue and 42 percent of assets; intermediate organizations account for the balance. (All financial figures are for 1995. Masters and Atkin, Table 1, *Industrial Relations*, Oct. 1997, p. 494.). Hence, it is clear that unions' power to generate in kind contributions, which are beyond any financial accounting, is widely spread across the country and therefore in a position to benefit the Democratic Party at all political levels.

One of the most valuable in kind services provided by unions to the Democrats are the unions' publications. These are mailed out to over 16 million members of unions implying a minimum household audience exceeding 30 million potential con-

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omment of union statistics by state and region. My statistical data have been republished by the U.S. Bureau of the Census. I have also written several books on these matters, the most recent (in 1999) is *Beyond Unions and Collective Bargaining*, published by M.E. Sharpe. My next book is titled, *Twilight for Unions*. Newspapers including the *Wall Street Journal*, have published my op ed articles, and in November 1999, *Forbes* Magazine did a feature article on me and my work. A Lexis-Nexis search reports more than 500 'hits' reflecting the number of times I have been contacted and interviewed by the news media across the country. In addition, I have appeared on television and have done numerous radio interviews. I have also testified before Congressman Thomas' House Committee on Oversight in 1996. A year later I also testified before Senator Thompson's Senate Committee on Campaign Finance Reform. In April 2000, I testified before the Senate Committee on Rules and Administration.

<sup>2</sup>Examples of in kind contributions are labor services to promote the election of candidates; the services of union members who volunteer their time for campaign activities; union officials and staff who spend time on campaign activities and organize volunteers, whether or not they receive their regular pay; provision of data and telephone banks on voters; registering voters, voter tracking and polling; getting out the vote, including services to transport voters to the polls; subsidizing delegates or alternates to national political conventions; exchanging research and strategy decisions with the Democratic Party; direct mail to members in comparing candidates' voting profiles, which almost universally caricature Republican candidates, and providing platforms for public personalities sympathetic to the Democratic Party to make speeches endorsing Democrats. Valuable services which unions provide the Democratic Party are political operatives whose salaries are paid by the unions. The two teachers' unions, the National Education Association and the American Federation of Teachers are reported to field more political operatives than the combined number of the Republican and Democrat parties. (Myron Lieberman in a communication to me, April 2000). This is particularly significant because these are professional operatives and activists, not volunteers who may be amateurs.

<sup>3</sup>Masters and Atkins' figures understate the totals because most public unions are not required to file financial reports with the Labor Department and, therefore, their figures, which are calculated from the Labor Department's data, necessarily understate the total. Thus, the state units of the National Education Association and the American Federation of Teachers (AFT), which do not report to the Labor Department, receive a combined income in excess of \$700 million, and their locals account for more than \$300 million in this time period. (Lieberman and Haar in a fax to the author). Taking these into account, the total income of the union movement is close to \$14 billion. Figures of unreported assets are not available, but obviously unions as a whole have more than the \$10 billion in assets calculated for 1995 by Masters and Atkin.



sumers of the unions' political point of view. These publications go out monthly. Thereby, they become a constant and repetitive advocate of the leadership's political views and these are uniformly in favor of the Democratic party. Most of the publications are issued by the national and international unions (parent organizations), but by many local and intermediate unions also publish and distribute their own publications. In addition, many unions maintain websites to transmit the official union line.

The union media is so biased in favor of the Democratic Party that it is no exaggeration to characterize the union media as a one-party press. The membership funds the union media from its dues and agency shop fees, *but these are not the measure of their in-kind value*. All in kind contributions must be construed in terms of what it would cost the Democratic Party to pay for this media.

Parenthetically, because the monies actually paying for the union media are collected almost entirely under compelled arrangements, the union or agency shop and the check-off, members and those represented by the unions are compelled to pay for political programs and candidates which they may not support, and in very many instances do not endorse. The managers, that is, the leadership, of unions contend that the political views expressed in the organizations media reflect the attitudes of a majority of its members, based on membership surveys. If this is so, why aren't the surveys' results, timing, methods including sampling techniques and margins of error and costs publicly disclosed? To date, I am unaware of any such disclosure. Most important, if these surveys are to represent the members' political views, why do individual members contribute so little to political campaigns? In fact, while organizationally the union movement contributed spent about \$100 million in the last presidential cycle, appeals to individual members—of whom there are over 16 million—brought in a mere 2 cents per member, a grand total of \$243 thousand. (Masters and Jones, *Journal of Labor Research*, 1998, Table 4). The minuscule voluntary cash political contribution of union members suggests that the claim of union management that they have the endorsement of members for their political endorsements is more rhetoric than reality.<sup>4</sup> Most important, this fact provides the strongest argument for the enactment of paycheck protection and full disclosure of what unions do with members' monies. Union managements' disregard, if not contempt for the views of substantial proportions of their membership, is especially egregious given that Ronald Reagan probably received a majority of private sector union members' votes in 1984, and close to that in 1980. To a very great extent, the term 'blue collar' Democrat of that era really meant and means to this day, blue collar unionists in the private economy. In 1996, Bob Dole won about one-third of all union households (meaning private and public combined), implying that perhaps 40 per cent or more of the private sector workers probably voted for him. Although public sector unionists vote more for Democrats than private sector unionists, a poll of the membership of the National Education Association (NEA), the largest union in America, with a membership of 2.4 million, reported about 30 per cent of its members regarded themselves as Republicans and another 30 per cent considered themselves to be independents. If so, this means that a minority is committed Democrats, but the NEA's leadership devotes nearly all its resources from compelled dues and fees to supporting Democrats.

The counter argument to the compelled union members' payments to support causes and candidates they oppose is that corporations also make political contributions which some shareholders may oppose. However, this comparison is invalid: Any shareholder, who objects to company policies of any kind, can sell his (her) shares at any time. And they have done so frequently as demonstrated by actions taken to show disapproval of apartheid, environmental practices and health (tobacco) and safety practices of the corporation. In contrast, a worker covered by a union shop agreement is compelled to resign his (her) membership to seek reimbursement of that share of dues which the union spent for political purposes. This is a high price to pay for a union member. It is a high price because it must take into account those union benefits financed out of dues (many of the old line AFL skilled unions continue to have these benefits) which would then be forfeited or denied. The price must also take into account that the same union and its officers will continue to represent the objector in grievance bargaining and bargaining in gen-

<sup>4</sup>The counter argument that individuals with business related jobs contribute amounts far greater than union members, as FEC figures show, is a red herring: It compares different and higher paying professional and managerial occupations with occupational categories much lower in the wage structure. Even so, given the high wages of many union members, and the fact that they are paid more than comparable nonunion workers, and that there are over 16 million members, would one dollar per member be too much for political causes their leaders claim the members endorse?

eral, and though nominally required to do so fairly, one must reckon with the world as is, not as thought to be. Moreover, the objector runs the risk of the disapproval of fellow workers for opting out and being “sent to Coventry.” To be sent to Coventry can be more than ostracism; it is often also means threats, intimidation and harassment. In contrast, the shareholder may even make a wise investment change, so it is evident that equating the union member working under a union shop and a shareholder who object to what their respective institutions are doing politically is not comparable.

### 3. *How I Determine the Value of In Kind Political Contributions.*

Calculating the value of each in kind contribution in an accounting sense is not possible because we do not know the universe and because each must be valued in terms of what it would cost the beneficiary, the Democratic party, in cash. Where labor services are involved, the detailed figures on the number of personnel and their earnings are not available. Moreover, expenditures are so classified by the Labor Department's reporting forms that they often conceal the true purposes of unions' expenditures. The Labor Department's financial forms which unions must file are useless for measuring political spending because of the nature of the financial categories. If corporations used comparable forms in their financial reports, stock exchanges would not list them and the IRS would reject their tax reports. Even if the Labor Department forms were amended in an effort to elicit the relevant political information, unions would obfuscate the true purpose of these expenditures in a labyrinth of categories. Moreover, there are no comprehensive figures available as to how many employees unions have, how many are detailed for political work, how many union members volunteer to do provide political activity and what should be the earnings they forego in volunteering. One insight into the extent of potential union member involvement in political activity are the contracts of the Auto Workers with the Big Three auto makers and Delphi, the parts maker, which give the members a paid day off on election day. The number of workers covered by these agreements is about 400 thousand. While not all will spend the day working on behalf of the Democrats, the union leadership will expect a large number to do so. *What is the value of this in kind labor service to the Democrats? Indeed, there really is a double value here: Because the members are being paid by their employers, it really constitutes their wage payments are a soft money contribution to the Democratic party. Finally, it should be noted that unions regularly assert that 'thousands' of members and union officials are active politically.*

The unions' in kind contributions demonstrate how public policy went off course. Public policy—the National Labor Relations Act—intended to encourage unions and collective bargaining. Building on that policy, unions' have increasingly shifted from their historic trade union function to a political function. Meantime, as it makes the switch, the union bureaucracy discloses little to the public which underwrote labor law or to the members whom it is supposed to serve on the extent of their political activity.

Given that a direct accounting method of calculating the value of unions' in kind contributions is not possible, I rely upon an economic principle to arrive at an estimate. The key to valuing the unions' in kind contributions is my concept of the political multiplier. It is the analogue of the Keynesian investment multiplier in economic theory, a concept which has been established for more than six decades. Conceptually, the political multiplier postulates that a cash political contribution will generate a multiple dollar value of in kind political contributions. The cash expenditures used in this analysis are the Federal Elections Commission's reports that in 1995–96, unions' PAC disbursements totaled \$100 million. (The actual figure was \$99,769,350). The political multiplier, estimated to be 3, therefore probably produced in kind additional contributions worth \$300 million. Hence, in the 1995–96 presidential cycle, the total value of unions' political contributions—nearly all of which went to Democrats—was worth \$400 million!

The multiplier, a number without units, is derived as follows:  
1/1—mpc

Here, the acronym, mpc, means the unions' marginal propensity to consume (demand) additional political services of the Democratic Party which is associated with the unions' cash expenditures for political purposes. Put another way, the unions' mpc for Democrat political services asks, what proportion of each additional dollar of the unions' additional income will the unions spend on in kind political services? Assuming, the midpoint between 1 (all additional income) or zero, no additional income will be spent on in kind services, one-half (.5) of each additional dollar of income would be spent on in kind political purposes. The multiplier would then be 2. [  $1/(1-.5) = 2$  ], and therefore that unions' in kind political contributions would

equal \$200 million in the presidential cycle of 1995–96. Together with their cash contributions of \$100 million, this would bring the total to \$300 million.

However, based on experience in the Beck (private sector; *CWA v. Beck* 487 US 935, 1988) and the Abood (public sector; *Abood v. The Detroit Board of Education* 431 U.S. 209, 1977) cases, a political multiplier of one-half is clearly too small. Judicial decisions concluded in the Beck case that unions spent less than 20% of their income on collective bargaining and related purposes, and even less in the Abood case. The remainder, the bulk of unions' income was allocated to other purposes, including political expenditures. The exact share going to political purposes is not known. However, given the often stated and forceful intention of the unions' management to implement their political objectives, and the range of possibilities opened up by the Beck and Abood cases, it is reasonable to estimate that the unions' political multiplier would be larger than 2. I estimate it to be 3. This means that the unions' marginal propensity to demand (spend) about two-thirds of each dollar of additional income, or .67, for political purposes.  $1/(1-.67) = 3$ . Therefore, the unions' in kind political contribution had an estimated value of \$300 million in 1995–96. Since total unions cash expenditures are likely to be no less than in the previous presidential cycle year, the political multiplier should be about the same, or perhaps slightly larger during the current cycle.

To critics who challenge my estimate of the unions' political multiplier, I call attention to additional millions of dollars in unions' cash contributions which I could justifiably have included in the base (the multiplicand) which is multiplied to derive the in kind total. Thus, in the 1995–96 election cycle year, unions spent \$50 million on categories of political expenditures other than PAC spending. (Masters and Jones, Table 4, *Journal of Labor Research*, 1999, vol. XX, No. 3, p. 311). Beyond these funds is the remarkable 1995 financial arrangement between the AFL–CIO and Household International: In exchange for the right to issue an AFL–CIO emblazoned credit card, Household agreed to pay the Federation \$75 million a year for 5 years for a total of \$375 million. Should annual \$50 million be added to the unions' political spending and thereby enlarge the value of their in kind contributions? To date, I am unaware of any public accounting of those funds—to what purposes they were put, and most importantly the apparent absence of any accounting to the public and to the members using the credit cards responsible for generating these payments to the AFL–CIO. The fact that a listing of the receipt from Household is reported by the AFL–CIO to the Labor Department hardly meets the goal of full disclosure: where did the money go?

#### CONCLUSIONS

In my judgment, there are numerous ethical and political problems with existing campaign finance legislation and policy. My recommendation, which I have consistently held, and presented in the past to the aforementioned Congressional Committees, is that contributions should be unrestricted for any domestic institution providing there is full and timely disclosure of the identity of the donor, the amounts contributed, and for which campaigns the contributions are made. This applies to both cash and in kind contributions. The most important reason for abandoning regulation of campaign finance is that the new regulation will surely fail just as it has in the past. Shrewd attorneys and clever judges will make Swiss cheese of any new legislation to regulate campaign finance. Finally, one may ask, are campaign finance matters the root of the perceived ills of the American political system? Free markets, albeit imperfect, have served this country's economy and society well. Why shouldn't they in the political market? To paraphrase Winston Churchill's comment on democracy, that democracy is the worst form of government—except for all the rest! Likewise, a free political market would be the worst form of raising contributions—except for all the rest, current and proposed.

Finally, irrespective of a whether there will be a free market in political giving, public policy should require full and timely disclosure to the public and to union members, in this particular instance, of the identity of the donor, the amounts contributed, for which campaigns, and must be applicable to both cash and in kind contributions.

#### APPENDIX

Major Democratic party services sought by the unions and referred to in the text are as follows: Restrictions on trade agreements, including extending most favored nation status with China; new labor law; minimum wage legislation, defeat of pay-check protection legislation; defeat of vouchers in education.

On these issues, just as on political expenditures the unions' managements often impose their own views despite the clash of interests between them and the mem-

bership and within the membership itself. The most notable is paycheck protection. Enactment of legislation which would require unions to obtain the signature of members before spending monies for political purposes would severely reduce the unions' management political power. Given the minuscule amount individual members voluntarily contribute is the strongest argument in favor of the legislation.

Another important union demand for Democratic Party services are restrictions on trade. The union leadership's demand that environmental and labor standards be included in trade agreements is actually intended to slow if not halt the importation of certain goods. These demands pretend that there are no such standards, when actually the International Labor Office has addressed them for years and the U.S. government is a signatory to these agreements. Moreover, as official members of the American delegation to the ILO, union representatives regularly participated in determining these standards.

The leadership's demand for separate American standards makes them the 21st century version of the Luddites. Adoption of these rules might benefit some private sector organized workers, but a far larger group of private sector workers organized and nonunion (who are 90 per cent of the labor market) would lose jobs, especially in the export industries. Needless to say, it will cost all consumers, reduce their standards of living, and reduce the output of the economy.

The position of the leaders of public sector unions on trade restrictions is even less defensible: The output of their members does not enter into the trade accounts, so they have no stake in protectionism. On the contrary, they have a stake in free trade. Trade restrictions will reduce their members living standards because they are also consumers. Similarly, this applies to the public sector members of private unions, a class of unions I have identified as the joint union. A particular case in point is the Service Employees International Union, the union once headed by John J. Sweeney, president of the AFL-CIO. About 75 per cent of its members are in the public sector, so their standards of living would be damaged by Sweeney's championing trade restrictions. If the U.S. has learned anything in the last two decades is the value of competition in furnishing goods and services, in this, the New Age of Adam Smith.

Another important example of the Democratic Party services which the teachers' unions in particular wish to obtain is the rejection of educational vouchers. The power of the teachers' unions is rooted in their monopoly control of public education; vouchers are a competitive challenge to that monopoly. By acquiring the Democrat Party's opposition to vouchers, the teachers' unions can maintain the status quo. So, like their confreres in the private sector, they, too, practice a 21st century version of Luddism.

Organized labor's partnership with the Democrat Party will lurch further to the Left as the new century unfolds. Because of the future demographics of unionism, the dominant force within the union movement will become the public sector unions. Atop this group are the teachers' unions, the NEA and the AFT, and they are much further to the Left than most other unions. I expect the two to merge in the near term creating the largest union in the world. As part of that merger, the NEA will affiliate with the AFL-CIO, and in due course, will supply the leadership of the Federation. That development will further cement the close political relationship between organized labor and the Democrat Party and their interdependence will inevitably shift the political orientation of both further to the Left.

Mr. PORTMAN. I want to thank all the panelists. I want to apologize that more members aren't here. The reason is we have had votes; and because this hearing was originally scheduled from 2 to 4 and the press and public were notified of that, there was some concern that we keep it moving so that we were able to hear not only all your testimony but have an opportunity for questions. After this vote, which is occurring now, I would expect members will begin to come back and have an opportunity to ask you questions.

I would like to get started with the questions so, if I might—and let me make the further point, Mr. Troy, that not only is the media here, you have got C-SPAN here. So your words are going out to hundreds of thousands if not a million or so Americans, and this

is also very important information that we are having read into the record to create a record of this hearing which will be distributed to all the Members. So we are here in a very important undertaking, and your words are being taken seriously and will be a major part of the deliberations as we decide what to do with 527s and other political activity.

If I could start, Mr. Makinson, with you and thank you for your good testimony and talk a little bit about what the Center for Responsive Politics does, you made the point at the end of your testimony that needs to be clarified, at least for my own purposes, about how, because 527s are unique, we need to deal with the 527 issue. After all, a foreign entity could actually be influencing U.S. elections through 527. And that certainly is a concern of mine and I think it is a concern of many of our colleagues.

My question for you is really pretty simple. Is it possible for a foreign government or a foreign person to contribute to a section 501(c)(4) organization?

Mr. MAKINSON. Frankly, I don't know the answer to that.

Mr. PORTMAN. The answer is yes.

Mr. MAKINSON. It is possible certainly for them—.

Mr. PORTMAN. It is a rhetorical question, since I knew the answer. Any other panelists would like to—maybe Mr. Potter remembers this back in his days as chairman or member of the commission, but the answer is yes. I would just make the point, can a (c)(4) engage in political activity?

Mr. MAKINSON. Sure.

Mr. PORTMAN. Yes. Can a (c)(4) lobby me?

Mr. MAKINSON. Sure.

Mr. PORTMAN. Can a (c)(4) lobby Congress?

Mr. MAKINSON. That is what they are for.

Mr. PORTMAN. As long as it is not a substantial—51 percent of its activities; is that correct? Would a (c)(4) have to identify such a foreign contributor to the general public?

Mr. MAKINSON. Only to the IRS if it was more than the amount. The answer is, no, they would not.

Mr. PORTMAN. The answer is, no, they would not.

What if that person donated a million dollars?

Mr. MAKINSON. The IRS would know. The public would not.

Mr. PORTMAN. The public would not know.

I only make the point that there are other types of tax-exempt organizations that can include elections today legally and keep their contributors anonymous. To say that somehow it is a unique problem with 527s I think misses the larger question. Maybe we cannot grapple with all these issues in this Congress, but I certainly hope we take our best shot at it.

I will have to leave now and vote. If you all can remain for a moment. Again, other members will be coming back and are eager to ask you questions. We will only recess briefly and again apologize for this interruption and appreciate your patience. Thank you.

[Recess.]

Chairman HOUGHTON. [Presiding.] Sorry about this. OK. Well, let's go ahead.

Did everybody testify? OK. Let's have some questions here.

Bill, have you got some questions? I have got some myself here.

I guess the thing that I am most concerned with is the shifting, if we close off the 527s, that so much of the activity then can move over to the—on 501(c)4s, 5s, and 6s. So what we are trying to do is to make sure that we shine enough light on some of these activities and yet not be so invasive it really gets into the privacy issue. Maybe you have got some comments to make on that, any one of you.

Ms. MITCHELL. Mr. Chairman, I am Cleta Mitchell.

In my testimony, one of the recommendations I would make to the Committee is that you do a couple of things that would require more disclosure but would not be too invasive and that is essentially requiring 527s to file 990s and work on—I have read in the reports from the staff and from the Treasury Department and others that the 990 provisions with regard to political expenditure reporting are aggregate, not—they are not very comprehensive. There is no reason that Congress couldn't work on that.

They already are required to disclose their political expenditures. If Congress is not satisfied that those disclosures are sufficient, then that is an area to work on.

The other thing I think is important is that another recommendation is that perhaps 527 Committees should not be for purposes other than related to candidates or political parties. That is what they started out to be. But part of this problem is the IRS decision several years ago to expand the definition of exempt purpose expenditures. That coupled with the decision of the IRS to deny tax-exempt status to a couple of Republican/conservative groups—the Christian Coalition being the best example, as well as the National Policy Forum. I think the IRS has to take a little more expansive view for allowing for issue groups to be 501(c)4s and make the 527s candidate Committees as they originally were intended to be or political parties and make everybody file a 990 and work on the 990 disclosure provisions for political expenditures instead of creating a whole new raft of regulations in the IRS.

Chairman HOUGHTON. That is very helpful. Go ahead, but I have got a question I would like to ask you, Mr. Moramarco.

Mr. MORAMARCO. The thing that the public is interested in, who are the major donors? The Supreme Court's concern was with corruption and the appearance of corruption; and if you get one piece of information from these organizations, it has to be who is contributing in amounts of 1,000, 5,000 amounts that people could consider corrupting so that when legislation comes up people will know, oh, that person may have been influenced here or not.

Chairman HOUGHTON. Let me talk about something that you mentioned, and that was the Snowe-Jeffords bill. You thought it was going in the right direction. I think it is going in the right direction. All of these things are going in the right direction. The question is, what is the extent?

One of the things that I worried about is, if you are just talking about broadcasting, television or radio, in this modern day of campaigning, with all the ins and outs, I mean not only the newspapers and direct mail but the Internet and the web and everything like that, I would just—I feel it is just too narrow. How do you feel about that?

Mr. MORAMARCO. I think you raise a good point. I think Snowe-Jeffords was crafted narrowly in order to try to get majority support in the Senate. I think it makes sense to look beyond to add things like direct mailing phone banks.

If you do that, I would caution you to add a significant dollar threshold. You don't want to get to the point where you are capturing Mrs. McIntyre who is delivering pamphlets on a street corner. That the Supreme Court told us you can't do.

If you want to start including things like phone banks and direct mail but you have a \$25,000 threshold, \$50,000 threshold, something that allows the Court to sit back and say, OK, we are going after people who are major players in this, I think that makes sense. There is nothing magic about the three that Snowe-Jeffords picked.

Chairman HOUGHTON. Right. Yes?

Mr. POTTER. Mr. Chairman, I think in that regard there is another aspect of Snowe-Jeffords that is worth noting and that is to deal with some of the constitutional issues of compelled disclosure. Snowe-Jeffords sets up a mechanism whereby an organization can establish a separate account and fund its political advertising through that account and then only need disclose the donors to the account. I think particularly for non-527s that has some real validity because that way you are not requiring that every donor to the organization or every large donor has to be disclosed when they may have given to the (c)(4) for nonpolitical, non-advertising purposes. And so that is an area of Snowe-Jeffords that I would commend to the Committee's attention.

Chairman HOUGHTON. Mr. Coyne. Thank you.

Mr. COYNE. Thank you, Mr. Chairman.

It has been suggested by some people that we expand this beyond the Snowe-Jeffords and go to the 501(c)4, 5, and 6 and be included in the legislation as it relates to section 527. Does any of the panelists have any concerns about the constitutionality of doing that?

Mr. POTTER. It depends, I think, Mr. Coyne, on how you do that. There are clearly constitutional issues here that are more severe for (c)(4)s than they would be for a 527 because a 527 exists for the purpose of election activity and the (c)(4) does not. Its principal purpose is otherwise. Thus, in my testimony when I talk about limiting the disclosure, I think the wider you are going to cast your net into (c)(4)s, 5s, and 6s, the narrower you are going to want that disclosure to be.

I would in particular urge the Committee that if you were going to require disclosure of any (c)(4) activity that you are going to have to use a definition that quite specifically and narrowly defines what that activity is. The 527 definition, which is political activity very much like the definition that the Court threw out in Buckley designed for the purpose of influencing a Federal election, that may work for 527s which, after all, are self-proclaimed political groups. That is what they have told the IRS they are there for, but I don't think it will work for (c)(4)s which have other purposes. So you are going to have to have a rather narrow definition as far as what has to be disclosed if you move toward disclosure in these groups.

Mr. COYNE. Can I take that that no other panelists has any constitutional concerns about expanding it into those other areas?

Ms. MITCHELL. Do not let my silence on the subject in any way infer consent. Because I absolutely think there are serious constitutional implications which is why what I said in my oral testimony, what I have said in my written testimony—I think it is very important, two things: number one, that you have to identify what the problem is that you are trying to solve. I think that is the underlying problem here. And then whatever solution is designed is narrowly tailored to address that problem.

What I think is going on here is that there is one stated problem but what really many are trying to accomplish is to create a whole new campaign finance regulatory apparatus within the IRS, and I find that very disturbing.

The second thing I would say is there is not one person on any of these panels here today other than, I suppose, Mr. Potter and me—I don't know if you represent any, but I do—who represents 501(c)4s, 5s, and 6s. I don't represent any 5s, excuse me, because we represent—no unions have hired us let me say that.

But I think that it is important to, first of all, know what it is you are proposing. I realize that everybody is trying to do this by Independence Day, which I think is utterly ironic, but it seems to me appropriate that Congress ought not to be stampeded into trampling on the first amendment rights of thousands and millions of Americans and that the first thing you ought to do is write a proposal and then circulate it, have time for people who are going to be affected by this, these hundreds of thousands of organizations.

I counted 280,000 4s, 5s, and 6s listed in your staff's information. Couldn't you find one of them to come today? It seems to me that the people who are going to be impacted by whatever it is you are going to do are more important than to sit and listen to your colleagues telling you why this needs to be done so it can be on the evening news.

I am very disturbed by this process, that you are not taking the time. This Committee thankfully is at least having a hearing, but this is not sufficient on this very important subject, and I would urge the Committee to slow down, give us a proposal, circulate it within the community that will be regulated which, ultimately, is all the citizens because they are the ones who join and pay dues to these organizations and let us have an opportunity for input.

Chairman HOUGHTON. Could I just interrupt? Lots of invitations were thrown out. Lots of information was out there. Very few people responded.

Ms. MITCHELL. Mr. Chairman, I will tell you—Mr. Chairman, I would like to—

Chairman HOUGHTON. Would you like to—

Mr. MAKINSON. Thank you, Mr. Chairman.

If there ever was a compelling argument why the Committee might want to narrow its scope on 527s, we just heard it. The last time that this issue came up that there was anything in Congress about regulating 501(c)4s, there was a rare agreement between the Christian Coalition, the Sierra Club and a whole other series of groups raising exactly those points. That is why I would take this



opportunity, if I could, to once again draw the difference—it is 527s which are completely invisible, absolutely invisible, which don't have to be organizations at all and all the other organizations out there.

If you look at ads produced by them, if the Teamsters or the Christian Coalition or the Sierra Club, which right now has issue ads on the air, puts their name on it, people know who they are. People don't know who Republicans for Clean Air or any of these other groups are, and there is—that is in a nutshell the difference between these groups and the others.

I do think, Mr. Chairman, that it probably requires a bit more concentration by Congress on applying this disclosure required requirement to the other groups. I do think it is a good idea, frankly, but I do think those other groups are going to rise up if you expand it that way. If that happened, it could block passage of something before the 2000 elections, which I think would be a disaster, given the potential for 527s.

Chairman HOUGHTON. Mr. Portman.

Mr. PORTMAN. Thank you.

Chairman HOUGHTON. I am sorry. Please go ahead.

Mr. MORAMARCO. On the question of constitutional concerns, just speaking for myself, I think the 527s are absolutely clear. There really shouldn't be any constitutional problem with regulating 527s because of the way they self-define themselves. When you move beyond that, there are constitutional issues. I don't think anybody can give a guarantee about what the courts will or will not accept. It just hasn't been done yet.

On the other hand, the reason I spoke in favor of Snowe-Jeffords approach is because I think a lot of thought went into that approach, was recommended by a lot of thoughtful people in the Senate; and in my view that passes constitutional muster.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Thanks very much.

Mr. Portman.

Mr. PORTMAN. Mr. Chairman, I won't take much time because I had the pleasure of hearing all the testimony and asking a couple of questions or one question of Mr. Makinson in your absence. Let me just make an observation.

Mr. Makinson's point is basically that even though we ought to have disclosure that is consistent among nonprofits that do political activity, which would include the 501(c)4s which we talked about earlier that would permit foreign nationals, as we said, to contribute and not be disclosed, it is just too hard to do this year; and that is fine. Maybe that is the answer. But let's not create this sense that the only problem out there is this unique 527 group that only recently has become a matter of concern and make arguments as we did earlier that, gee, it is because foreign nationals can contribute to a 527 and therefore corrupt the political process, and that is why we need to get at 527s. I would just hope that we would keep this on an honest level, that there are a lot of problems out there.

I appreciate your comment a moment ago that you would like to see disclosure in these other categories but you think this year, perhaps an election year, although you didn't say that—I'll say

that—it might be difficult to get our hands around the bigger issue, and Mr. Moramarco says a lot of work has gone into the other one, maybe not as much work into this—maybe. There is a lot of thought that has gone into this as well, and I know Mr. Houghton has put a lot of thought into it.

I would hope before we throw in the towel and say, gee, we can't get at the bigger problem because it is not politically doable, let's talk about the right thing to do. I think the Center for Responsive Politics focuses on the right thing to do in their other work. I hope they will focus on it here.

Ms. Mitchell has her views on what the right thing is to do. I know you all don't agree often not just on this issue but other issues with regard to political activity, disclosure, not just in the disclosure area but generally with regard to campaign finance. I would hope that we could at least keep this at a level that there are other problems.

That is really the point I was trying to make earlier that has come out with regard to our other questions and our other witnesses that if, we really need to get beyond this problem, we need to get beyond the immediate sort of political hit of the day and whatever is the seemingly easy target right now and look at the broader issue and what is going to happen when we push down on one side, it is going to pop up somewhere else. And I think our lesson from the seventies has to be that it is never going to be perfect but that we need to look at the bigger picture as well.

With that, I would yield back my time.

Chairman HOUGHTON. Thank you.

Would you like to go, Lloyd? Please, you go ahead.

Mr. DOGGETT. Ms. Mitchell, I believe that you are principal advisor for J.C. Watts' Citizens for a Republican Congress.

Ms. MITCHELL. J.C. Watts has nothing to do with that organization.

Mr. DOGGETT. Are you principal advisor for—

Ms. MITCHELL. I am legal counsel to Citizens for a Republican Congress.

Mr. DOGGETT. And it is a 527?

Ms. MITCHELL. It is a 527 Committee, and let me say the reason why. Because after talking with the people who wanted to put that together, I advised them, based on the IRS rulings, that I did not think that they could qualify for a 501(c)4 status even though they had no interest in being involved in any campaigns but because they wanted the name Republican in their name.

Mr. DOGGETT. It still has as its goal raising \$30 million for this election cycle?

Ms. MITCHELL. No. That was never true. That is what I am saying. This is legislation by headline.

Mr. DOGGETT. What is its objective in terms of funds?

Ms. MITCHELL. Well, it had an objective to raise a lot of money. They just haven't been able to do that.

Mr. DOGGETT. They couldn't get the \$30 million?

Ms. MITCHELL. They really didn't—no, that is basically correct.

Mr. DOGGETT. What other 527 organizations are you affiliated with?

Ms. MITCHELL. Affiliated with or represent as an attorney?

Mr. DOGGETT. Either one.

Ms. MITCHELL. Our firm represents a number of candidate Committees. I am sure all of you are aware that your candidate Committees are section 527 Committees.

Mr. DOGGETT. I am talking about the undisclosed non-candidate Committees.

Ms. MITCHELL. Well, do you consider GOPAC an undisclosed non-candidate Committee?

Mr. DOGGETT. Is that one of your—

Ms. MITCHELL. That is one of our clients.

Mr. DOGGETT. Are there any others?

Ms. MITCHELL. That is plenty.

Mr. DOGGETT. Pardon?

Ms. MITCHELL. That is plenty.

Mr. DOGGETT. Are there any others?

Ms. MITCHELL. There may be. I didn't bring my entire client list, but we represent a number of candidates, candidate Committees.

Mr. DOGGETT. Can you name any of your other 527 clients that you represent that are involved in attempting to influence this election cycle?

Ms. MITCHELL. I represent some 527—we represent some 527 Committees that are not involved in any way in the election cycle.

Mr. DOGGETT. Do you represent any that are involved in the election cycle?

Ms. MITCHELL. No.

Mr. DOGGETT. I gather that you disagree with Representative J.C. Watts' comment that he had no problem with full disclosure for 527s?

Ms. MITCHELL. I am not aware of what he said. I have a lot of problems with the fact that a number of Members of Congress have made statements on this subject that seem to me to be ill-advised and uninformed, but that is not the first time that is going to happen.

Mr. DOGGETT. I am sure it won't be the last.

Ms. MITCHELL. And, frankly, the fact of the matter is that is why citizens groups ought to be able to exist, to call you on it when you make those kind of dumb statements.

Mr. DOGGETT. Thank you very much.

Mr. POTTER, I want to thank you for the leadership you have shown not only with reference to the issues we are discussing today but on campaign finance issues generally. I know that you mentioned that one of the areas that Buckley refers to and that has been an issue is the potential for campaign contributions to cause corruption; is that correct?

Mr. POTTER. That is right.

Mr. DOGGETT. Isn't that potential for corruption greatly increased when the money can be taken without any disclosure as to when or how much or from whom it has been taken?

Mr. POTTER. The Court found that was the case when it upheld the requirement for disclosure of independent expenditures in the Buckley case.

Mr. DOGGETT. From your experience on the FEC and as a lawyer and as someone involved in the political system, don't you find that to be true, that the potential for corruption of our political system

without regard to any particular individual or political philosophy is significantly increased when the contributions in the old sense, I guess, of the bagman where the bag of money can come in without anyone knowing who it came from in the public, how much it is, and for whom it came?

Mr. POTTER. I think the Court was right that disclosure is important for those reasons.

Mr. DOGGETT. Professor Hill, you heard my comments earlier on the panel with Senator McCain concerning the importance of effective date. If we do not in the effective date include those contributions that have been raised from secret sources throughout the year 2000, what do you think the effect of the legislation will be?

Ms. HILL. I think the effect of the legislation would be to create what legal academics are fond of calling a moral hazard, which is to say an invitation to bad behavior given the last legally available moment. And, frankly, most private lawyers would feel compelled to advise their client if they still had a window to get it done fast. So retroactivity is not unknown by any means in tax measures and would not be I think particularly controversial, especially in view of the moral hazard of a prospective effective date for something like this.

Mr. DOGGETT. Thank you and for your leadership on this 527 issue.

Mr. Makinson, I have been concerned that on the Senate side, unlike the bipartisan character of this hearing, those who advance the McConnell—I will get it right in a minute—the Senator from Kentucky and his colleagues who have advanced a proposal there seem to be the same group of people that took such pride in killing the McCain-Feingold broader campaign finance system. Is it your belief that if our choices are to load down this bill in a form that they will eventually be able to kill it over there or simply pass a 527 proposal along the lines that I have advanced and add on perhaps Snowe-Jeffords, that we would be better off doing the latter?

Mr. MAKINSON. Mr. Doggett, that is a political question. And since we are a (c)(3), not a (c)(4), I haven't practiced in those sort of arguments.

Mr. DOGGETT. I will take that as a fair answer, but maybe you can, within your tax-exempt status, maybe comment.

Mr. MAKINSON. I will try. By far the most dangerous loophole we have this year are 527s, witness the rush to them because they give such unlimited flexibility.

I might point out this is true of both the right and the left. The Sierra Club is doing this as well as groups on the right. And, frankly, the hallmark of people in the past on the Hill not wanting to change the laws has always been what we need is disclosure, so we are now beginning to hear for the first time what we have to be concerned about is privacy and that that somehow ranks higher than disclosure.

I think that there is some legitimate questions about privacy that need to be addressed. But the real question here, and the question I think that Congress is justly dealing with, is, frankly, the question that the public is going to be asking this year more than ever, is who is paying for this election. If that answer can't be given, if there is one class of Committee that can put political

ads on the air that doesn't have to answer that question, then the prospect that this whole Congress may face is that we can have an election on the 7th of November in which a lot of the public doesn't have faith in the results of the election because it may have been influenced at the last minute of the reality that we face with this loophole, particularly the loophole of the 527s, is negative ads the last week before the election coming in like a neutron bomb. They are coming out of nowhere, doing their damage and disappearing.

We don't have any other means for affecting Federal elections that is quite as potent as these 527s. Therefore, I would say if you can narrowly address that most important problem and that biggest danger and then if you can get more beyond that, terrific, but don't fail to do something about 527s before the elections or it may haunt us all.

Mr. DOGGETT. Mr. Moramarco, you have mentioned in answer to earlier questions your support for the concept of the Snowe-Jeffords proposal. It focuses, of course, on broadcast ads. Is there anything in the Court decisions or in terms of good policy that would limit our expanding that to cover print ads, direct mail, things of that type for the same time period?

Mr. MORAMARCO. No, I would only add that a dollar threshold would be important to not cover de minimis spending. Leaving that issue aside, it is appropriate.

I want to add I hope my earlier comments weren't taken by anyone to imply that I didn't think the bill currently before the House is a very thoughtful one. I think it is.

Mr. DOGGETT. Thank you.

Chairman HOUGHTON. Dr. Troy.

Mr. TROY. I just want to repeat my recommendation and maybe elaborate just a little that we should go to a political free market in determining what people will give as long as there are individuals, organizations, in kind or in cash, that all this should be only subject to complete disclosure.

And I want to add this comment. Churchill said of democracy, it is the worst form of government except for all of the rest. A politically free market may be the worst way of handling campaign finance reform except for all of the rest. With all due respect to this Committee and those in the Senate, legislation will surely find its way into a Swiss cheese factory and it really is—all of these proposals wind up being, with all due respect to lawyers—and my son is a graduate of the Harvard Law School—this is “make work” for lawyers.

I think the free market, which has served us so well in the economy—this new age of Adam Smith, I think it is time for the political world to move into the new age of Adam Smith. Thank you.

Chairman HOUGHTON. Thank you, Dr. Troy.

Mr. Thomas.

Mr. THOMAS. Thank you very much, Mr. Chairman.

Mr. Makinson, I wouldn't worry about the voters' reaction to this election on the 527 question, since you strongly advocated in your testimony, and others', to focus on the 527s. There are plenty of 501(c)(4)s that, through an educational process, have told us that Members of Congress are bought and sold.

If you are really worried about the pivoting of this election on somebody spending some money, I wouldn't be so concerned about focusing totaling on the 527s.

We also hold these hearings to try to shed some light on an area that probably needs to be addressed; and we bring panels in to try to shed light rather than obfuscate. And I apologize for not being here the whole time, but when I hear a phrase like "527s are invisible," I don't think that you meant to say that as a blanket statement.

Is that correct, Mr. Makinson?

Mr. MAKINSON. I am not sure that I said "invisible." I believe I said "phantom Committees."

Mr. THOMAS. Do you believe that all 527s are phantom Committees?

Mr. MAKINSON. Not at all.

Mr. THOMAS. When you say 527s are the problem, as a legitimate candidate that files for office, I am a 527.

Mr. MAKINSON. Exactly. And I think the traditional use of 527s is part of our political—

Mr. THOMAS. OK. But Mr. Moramarco earlier said it was because of the failure to get four votes on the FEC.

I don't think that is the problem. I think if you go back and look at the letters issued by the IRS, that says that somebody can create a personal dilemma for themselves by becoming a 527, which prior to the IRS letters were all political and they had to file and disclose. Now the IRS says you can in your charter or by vote say, we don't advocate the election or defeat of someone; therefore, we are not constitutionally engaged in political activity, but are a 527.

So IRS was the one that allowed people to produce this double screen, but not everybody in the 527 category gets the double screen—only those who fall in the political category who announce themselves as nonpolitical.

Why in the world wouldn't you be in support of going after, in a reasonable and appropriate way, the point that you say that you have always wanted, which is disclosure; but why in the world would you create a structure which produces only a 527 disclosure when the exact, same activity carried on by a (c)(4), (c)(5) or (c)(6) would not be disclosed if you take only the Doggett legislation and add Jeffords v. Snowe.

Are you telling me that there is none of a similar activity going on in (c)(4)s, (c)(5)s and (c)(6)s? Of course, you can't say that.

I would hope that if you are coming here as experts on the subject matter, you don't just shill for a 527 disclosure and say, gee, let's not do a reasonable and appropriate effort. You are doing a disservice to a period in time which might be able to deliver something that I didn't think we were going to deliver this soon; and that is a relatively broad disclosure provision and expenditure provision from groups who have chosen to be in a tax-benefited category. Nobody put them there but themselves. They chose the tax-preferred position.

Mr. Potter, I would like a reaction to this statement. I believe that the Supreme Court's discussion in Buckley v. Valeo about the criteria for disclosure on political activity isn't a constitutional criterion that this Committee, the Ways and Means Committee in

dealing with the Tax Code has to adhere to in terms of saying what the ground rules are to play in the tax-preferred area. I believe we can define a reasonable and appropriate political activity which isn't just the narrow advocacy of the election and defeat, but a broader definition of disclosure; and if those organizations don't like that definition, they don't have to be a tax-preferred Committee.

Mr. POTTER. Yes, I think one of the points that came out of Mr. Portman's earlier discussion with the witness is that the IRS has very broad and very murky rules at the moment for what constitutes political activity, that I think would never stand up if you were not dealing with an organization that had a tax preference there.

Mr. THOMAS. As I said at the beginning, if someone wants to avoid any impact by any of these bills that we have looked at, all they have to do is be a for-profit and carry on their activity, and they may or may not make a profit.

So anybody who thinks that they are stamping out, or any member who stands up and says, or any organization that labels responsive in its title that we are going to stop these kinds of activities, really either is doing it for some other reason than I can understand or doesn't understand what we are doing.

All we are saying is, if you want this tax-preferred position, from now on you are going to have to disclose both in terms of where the money comes from, above-appropriate expenditures, the expenditures above an appropriate threshold.

My only concern, I hope someone took a look at the 501(c)(3) political criteria, and if we are going to be dealing with (4)s, (5)s and 6s and 527s under a reasonable and appropriation definition of involvement in an election, you have now created a loophole in the 501(c)(3) which goes back to the court test of actively engaged in an election. We probably should carefully examine 501(c)(3)s as well.

You people should have uniformly encouraged us to take the current opportunity and not just go after one section of the Code, but create a reasonable and appropriate disclosure in 501(c)(4)s, (c)(5)s and (c)(6)s and look at the definition in 501(c)(3)s to see if we need to change it.

I frankly am disappointed that some of you who profess to be professors came on and shilled in a very narrow way for a specific proposal. I would have expected a broader understanding of the opportunity we have available; but after all, you also not only have to be knowledgeable, but understand politics. This is a window; this is an opportunity.

The gentleman from New York, the chairman of this Subcommittee, is in the lead and his name is absolute triple A gold bond. When he says he wants to move an appropriate and reasonable bill, he has a better chance than anyone I have known in the 22 years I have been here to do that. Support him.

Thank you, Mr. Chairman.

Mr. PORTMAN [presiding]. Do we have any more questions from the panelists?

Mr. Coyne.

Mr. COYNE. No.

Mr. PORTMAN. I think it would be appropriate to give the members of the panel an opportunity to respond appropriately, and then we will adjourn the hearing.

Ms. Mitchell.

Ms. MITCHELL. Mr. Thomas, I think Mr. Portman can attest, I did not necessarily agree with the other comments that were made. My proposal is that I think it is important to have—to treat tax-exempt groups alike. And my suggestion to the Committee is to look seriously at three types: Number one, requiring 527 Committees to file 9nineties like (4)s, (5)s and (6)s; number two, to look at the political expenditure provisions that are already contained on the 9nineties, and if they are insufficient to address that and make them more comprehensive or more satisfactory; and number three, to consider addressing to the IRS the issue of returning 527s to their original intended purpose, but at the same time allowing organizations that come to the IRS that really are issue-based organizations not to be unfairly denied their applications to be 501(c)(4)s, as has happened to the Christian Coalition and to the National Policy Forum. I think there are some narrowly tailored solutions which could pass constitutional muster.

Let us not forget that the canard here is disclosure. Senator Lieberman made reference to the canard, every dime of soft money which is given to the national party Committee and every dime expended; and that was the evil of the day until 527s came along to be the new evil of the day. Disclosure is not what campaign finance reformers are after; they want to eradicate even that. So disclosure is only the first step to eliminating and regulation.

Mr. THOMAS. May I respond just briefly?

Mr. PORTMAN. Mr. Thomas and Mr. Hill and others.

Mr. THOMAS. I didn't mention you specifically, so by omission, you should have considered that I didn't.

The concern that I have is that you can never put the genie back in the bottle. What we have to do is say, if there are organizations out there that function for good and worthy purposes that ought to have a tax-preferred position, this is not going to be a backwater for people involved in politics to use a subterfuge to cover up their activities.

What the IRS has allowed is a fish to call itself a fowl, and we need to go in and make sure that the entire category is taken care of, not just one particular area that has been latched on as a political device to create additional images of people bought and sold, or activities carried on under the guise of education to subvert American politics.

I want to make sure that doesn't occur whether it is a labor organization, an associational organization, or someone engaged in educational activities. I would hope others would have the same concern.

Mr. PORTMAN. Mr. Potter.

Mr. POTTER. I agree with Mr. Thomas that this is a historic opportunity. I think it is important, as you move through this to work very carefully, to make certain that you don't overreach. I think the opportunity includes all of those categories.

I have read the comments for instance of the independent sector, which talks about some of the specific constitutional issues for the



(c)(4)s and I think they are there. Your comments about for-profits, I am trying to address that in my written testimony.

I would make two points. One is, as you know, you are never going to solve this in one instant blow. You will make a good start, but you will find next year that something else has come up, and you will find that there is some other way around this; and at some point you will have another panel, because you will have a disclosure problem. That is fine. That should not prevent you from doing something today, knowing that you cannot be all-inclusive and that something will turn up that you will have to address in the future.

I also don't think that you can go back though, in all due deference to Cleta, you can't turn around and say to the IRS, redefine 527s again, because you had a real problem out there. On the Democratic side, the Democratic Leadership Council, on the Republican side, the Christian Coalition, were organizations that a couple of years ago did not have a home at all. They were not (c)(4)s under the Tax Code, and in the IRS view, they were not 527s because they did not engage in express advocacy. It seems to me that the point is, are you going to get to disclosure of their candidate-specific advertising which is how you all started this today?

Mr. POTTER. Ms. Hill.

Ms. HILL. I really agree with Trevor Potter's comments, and I am very cheered by the spirit of bipartisanship that we saw on the panel of Senators and Congressmen who came forth today to talk about trying to achieve the achievable and not letting the perfect destroy the achievable at a particular time.

Had Representative Thomas' staff had a chance to brief him on my testimony, he would perhaps feel more assured about the scope of the comments; and I will leave his staff to do that at their leisure.

Mr. PORTMAN. We will stipulate for the record that Ms. Hill testified in her written statement about problems both with 527s and the 501(c)(3), (4), (5) and (6)s, although your oral testimony was slightly more focused on the 527s.

Ms. HILL. Five minutes is 5 minutes.

Mr. THOMAS. Since my name was mentioned, I will tell you I don't have my staff brief me; I read the testimony.

Ms. HILL. I am sure you do.

Mr. THOMAS. In your written testimony, it says one thing, and in your verbal, it says another in terms of not being as stressful of certain points. The point I wanted to make was who determines what is achievable. It probably ought not to be labor unions and groups on the right; and it probably ought not to be college professors or ex-college professors, because we tend to underestimate the achievability of something.

Ms. HILL. To the extent that broader disclosure is achievable with the kinds of safeguards that Trevor Potter mentioned and we don't need to repeat, that is a useful idea, as my written testimony indicates, and I would call the Committee's attention to the taxation with representation case where the Supreme Court provides some useful guidance that you might wish to consider, that not every exempt organization has a full range of participatory rights. But the court emphasized that citizens must have the right to associate together in some other type of entity, and I would urge you

not, in whatever logroll you engage in, to lose sight of that part of taxation with representation as well.

The idea of moving forward on broader disclosure of contributors is certainly, I think, a worthy idea, and I hope that it is done with the kind of care for which Mr. Potter has provided useful guidance.

Mr. PORTMAN. We are in a freewheeling discussion which is hopefully going to help us move forward, and I think this is a good dialog, and it has been a bipartisan effort.

Are there any other members of the panel who feel the need to express a view? We will turn the light on one more time because members have to go, as do others.

Mr. Makinson.

Mr. MAKINSON. I want to say I agree with Mr. Thomas that we need as much disclosure as we can possibly get, and I would like to commend the Commission, I have never been before Congress before, I have never had occasion to; and that is because Congress hasn't passed any campaign finance law in 20 years that we have groups rushing to the IRS to find the equivalent of a tax loophole, and I really applaud your efforts to have Congress decide what the rules are and not the IRS and not the courts.

Mr. THOMAS. There have been a number of excellent bipartisan modest modifications to campaign laws over the years, and organizations out there have said, if you don't fundamentally change everything, we are not going to support it. It has been extremely difficult. Had we done this in a—solved the problem as we moved along, we would be a long way down the road.

But we also not only have to deal with the question of participation in elections, but frankly, Mr. Moramarco, we have a constitutional right to privacy which we have to balance while we balance all of these other rights as well.

Mr. PORTMAN. Other panelists. Mr. Moramarco.

Mr. MORAMARCO. I agree with Mr. Thomas, that everything I have heard about this Committee is, it is struggling very hard to come up with a workable solution to this, and this really is a window of opportunity, so I am not exactly sure who I am supposed to be shilling for or not shilling for. That comment kind of surprises me.

All I want to share with the Committee is my view that when there are problems of the type that Representative Thomas has addressed, which are, these groups could reorganize as for-profits the very next day, it makes sense not to attack this just through the Tax Code, but to look at an approach like Snowe-Jeffords which looks at actions that would apply to anyone regardless of how they are organized by tax status.

And I agree we should go as broad as achievable, but there seems to be legitimate disagreement among people how you proceed beyond 527s, but I think it would be a good thing.

Mr. PORTMAN. Professor Troy?

Mr. TROY. I have nothing to add.

Mr. PORTMAN. Thank you all very much for great testimony. With that, the Subcommittee is adjourned.

[Whereupon, at 5:16 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

ALLIANCE FOR JUSTICE  
WASHINGTON, DC 20036  
July 5, 2000

A.L. Singleton  
Chief of Staff  
Committee on Ways and Means  
U.S. House of Representatives  
1102 Longworth Office Building  
Washington, D.C. 20515

RE: Disclosure of Political Activities of Tax-Exempt Organizations

Dear Mr. Singleton,

The Alliance for Justice welcomes this opportunity to submit comments for the record regarding the various recent proposals for enhanced disclosure relating to the political activities of tax-exempt organizations. In particular, we are concerned about proposals that would have reached beyond organizations described in Internal Revenue Code Section 527 and would have required 501(c)(4), 501(c)(5), 501(c)(6) and perhaps even 501(c)(3) organizations to disclose extensive information about contributors and expenditures the organizations made in their efforts to inform the public about important public policy issues. It is important that the committee recognize the clear constitutional concerns that arise whenever the government seeks to regulate speech by organizations created to advocate for a particular public policy issue and the difficulty of separating that speech from partisan candidate activities. The Alliance opposes the recently passed H.R. 4762, although we recognize that other recent proposals designed to regulate speech by tax-exempt groups were even more seriously flawed. These proposals trample the First Amendment and injure other policy interests in pursuit of goals that the proposals either fail to achieve or that may be achieved with less harm to the public.

The Alliance for Justice is a national association of environmental, civil rights, mental health, women's, children's, and consumer organizations that works to promote public participation in the decisionmaking process. Our members and the other groups with which we work are tax-exempt organizations that are committed to working on public policy issues. Although few, if any, of our member organizations operate the type of 527 organizations regulated by H.R. 4762, the Alliance is concerned about the impact that this bill and the other proposals that have been discussed might have on the ability of organizations to advocate for the public interest.

*I. Proposals that would require sweeping disclosures of contributors by tax-exempt organizations are unconstitutional.*

Proposals requiring extensive disclosure of contributors by advocacy organizations violate the First Amendment of the Constitution. The government's interest in requiring such sweeping disclosure does not rise to the level necessary to restrict these freedoms.

The First Amendment protects the rights of people to come together to advocate for or against a particular cause, and the Supreme Court has held that this right includes the right to speak anonymously in some circumstances. In *NAACP v. Alabama* (357 U.S. 449 (1958)), the Court struck down an Alabama law that would have required the NAACP to make public the names of its supporters in Alabama, citing the risk that if the names of these civil rights activists were known they could become victims of the Ku Klux Klan and other violent supporters of segregation.

To be sure, the Court is willing to require disclosure where there is a compelling government interest. Citing interests in support of disclosure, such as the need to avoid the appearance of corruption created by large campaign contributions to candidates, the Supreme Court in *Buckley v. Valeo* (424 U.S. 1 (1976)) upheld the Federal Election Campaign Act's requirement that independent contributions and expenditures be disclosed. However, the Court found it necessary to limit that disclosure to contributions and expenditures for activities coordinated with a candidate or communications that included "express advocacy"—communications that included explicit calls to support or oppose a particular candidate. With regard to attempts to require broader disclosure, the Court found that "the relation of the information sought to the purposed of the Act may be too remote." (*Id.* at 80.)

The Court in *Buckley* also noted that the broad scope of the law left members of the public uncertain as to when the law applied to them. This vagueness also undermined the constitutionality of the FECA because the law failed to "provide adequate notice to a person of ordinary intelligence that his contemplated conduct is illegal." (*Id.* at 77.)

H.R. 4762 and, to an even greater degree, the other recent proposals in this area reach substantially beyond the narrow ruling in *Buckley*. In particular, the more extreme proposals, such as H.R. 4717 (the bill passed by the full committee), are overbroad, requiring many different types organizations to disclose contributions and expenditures not merely for “express advocacy,” but also legislative advocacy and public education. For example, H.R. 4717 would require disclosure of contributors to and expenditures by a 501(c)(4) organization that spent more than \$10,000 in a year on television advertisements featuring a candidate. This requirement would reach not merely political ads but also lobbying activities, such as an advertisement that seeks to influence a legislator’s vote on pending legislation. The requirement would even reach a public service announcement that featured an elected official who happened to also be running for reelection.

To the degree that proponents of this legislation argue that these proposals are not intended to reach such communications, it merely demonstrates the failure of these proposals to guide the public without overstepping constitutional lines. This vagueness in the language makes these proposals constitutionally defective.

These are not mere technical concerns—they directly undermine the vital public policy interests that underlie the First Amendment. The type of speech that these proposals would regulate—discussions of policy matters and the qualifications of candidates for office—are the heart of the speech that the First Amendment protects. Yet the loss of the ability to speak anonymously can chill that speech. In some cases, people who face forced disclosure of their identities will not speak out of fear of physical or economic retribution, as in *NAACP v. Alabama*. In other cases, a speaker may want listeners to focus more on the message than on the messenger. The key architects of the Constitution published *The Federalist Papers* under the pseudonym “Publius,” allowing the public to debate issues rather than personalities. In some cases the desire for anonymity may derive from cultural traditions favoring anonymous giving or even a mundane interest in avoiding the solicitations of other would-be recipients of contributions. Regardless of the motivation, the fact is that fewer people will participate in core public policy debates if they are not able to do so anonymously.

In short, because the proposals would extend to cover speech far beyond the political arena where avoiding the appearance of corruption constitutes a compelling rationale, the government’s interest in requiring disclosure of contributions and expenditures by these organizations for these activities does not rise to the level necessary to allow interference with vital First Amendment rights of speech and association.

## *II. Less harmful alternatives exist for achieving the goals of H.R. 4762 and the other proposals.*

There are other ways to protect the public from fraud that do not create the constitutional concerns raised by H.R. 4762 and the more sweeping disclosure proposals that have been debated.

The impetus for this flood of legislation is also the evidence that demonstrates how unnecessary it is. When the “Republicans for Clean Air Committee”—a 527 organization—began running ads suggesting that Texas Governor (and candidate) George W. Bush had stronger environmental credentials than Senator (and candidate) John McCain, a vigorous press corps, supported by the McCain campaign, tracked the source of the ads to Sam and Charles Wyly, longtime supporters of George W. Bush. Indeed the vigor of the press corps is directly proportional to the impact that these organizations are having on the campaign, and the victims of such an attack are likely to help uncover the truth. Thus, the greater potential harm to the electoral process, the more likely that those responsible will be unmasked by the media.

Furthermore, the public is capable of evaluating the anonymity of the speaker in weighing the message. To at least some degree, people discount information from sources they do not know. As the Supreme Court said in upholding the right to anonymous leafleting in *McIntyre v. Ohio Elections Commission*:

Don’t underestimate the common man. People are intelligent enough to evaluate the source of anonymous writing. They can see it is anonymous. They know it is anonymous. They can evaluate its anonymity along with its message, as long as they are permitted, as they must be, to read that message. And then, once they have done so, it is for them to decide what is ‘responsible,’ what is valuable, and what is truth.

(514 U.S. 334, 349 n. 11, quoting *New York v. Duryea* (citation omitted).)

The ability of the press to uncover those who seek to abuse the right of anonymity and the public’s ability to evaluate that anonymity can be strengthened with more

limited disclosures than those proposed by H.R. 4717. The Alliance for Justice supports a requirement that all organizations seeking tax-exempt status under Section 527 register with the Internal Revenue Service and file an annual Form 990 information return subject to the same disclosure requirements that cover other tax-exempt organizations. This would make public key information, including the names of the organization's officers and highly paid consultants. This information will frequently provide enough information for reporters and the public to determine what interests lie behind the organization.

In general, contributors to a 527 would not be disclosed on the publicly available version of its Form 990. Although this information is generally reported to the IRS on Form 990, most tax-exempt organizations are permitted to exclude this information from the copies of the Form that they make available to the public. The one exception to this general rule is that private foundations—which receive funds from only a limited number of sources, rather than through support from the general public—must disclose the source of their funds on publicly available 990s. The Alliance would support such a requirement for 527 organizations that fail to meet a similar public support test. This would directly address the most troubling use of this type of organization, diminishing the ability of a few individuals to masquerade as a group with broad public support.

### *III. Legislation limited to 527 organizations would be ineffective and dangerous.*

It is possible that legislation, such as H.R. 4762, requiring broad disclosure only by organizations created under Section 527 would pass constitutional muster. However, such legislation would fail to stop determined individuals from supporting anonymous issue advocacy through other types of organizations. Such legislation will inevitably lead to renewed calls for more sweeping, unconstitutional disclosure requirements on non-527 organizations.

Although the Supreme Court has been reluctant to impose burdensome restrictions on the speech and associational rights of individuals, it has been more willing to impose such restrictions as a condition of receiving certain tax advantages. For example, the Supreme Court in *Regan v. Taxation With Representation of Washington* (461 U.S. 540 (1983)) found that the Internal Revenue Code's restrictions on lobbying by 501(c)(3) organizations withstood First Amendment challenge because the organization had the option of conducting lobbying activities outside the 501(c)(3) structure, either by forming as another type of tax-exempt organization or creating such a group as an affiliated organization.

In H.R. 4762, Congress has chosen to make granting of 527 status contingent upon compliance with extensive disclosure of contributors and expenditures. The bill has a certain intuitive appeal given that all 527 organizations, by definition, have the intent to influence elections as their primary purpose. (Although it is worth noting that 527s may also engage in non-electoral activities, such as efforts to support or oppose nominations for certain appointed offices.)

One problem with this "solution" is that it will merely create a flight to other types of organizations. Faced with greater barriers to the use of 527 organizations, those determined to espouse their ideology anonymously will likely create other types of tax-exempt organizations—or even "for-profit" corporations—that remain tax free because they never show a profit. (Indeed, it was just this type of unintended consequence that led the growth of the "new" 527 organizations as would-be donors sought to avoid the gift tax burdens associated with giving to 501(c)(4) organizations.)

A more insidious problem with a disclosure provision limited to 527s, however, is the inevitable desire it will create to impose similar requirements on 501(c)(4)s, 501(c)(5)s, and 501(c)(6)s. Congress wisely decided to avoid this pitfall in passing H.R. 4762, but because issue advertisements created by 527s are indistinguishable in content from those produced by these other types of tax-exempt organizations, it will be all too easy to slide down the slippery slope and seek to regulate these other types of organizations. As described above, such an effort would be a clear violation of bedrock constitutional principles.

Simply because it may be possible to regulate 527s does not mean that it should be done. Indeed, some of the same concerns about associational rights and the value of anonymous speech discussed above apply to individuals that come together in 527 organizations as well. Regardless of the potential merits of these policy arguments, however, it seems clear that efforts to regulate only 527 organizations will fail to achieve the sponsors' desire results and may open the door to more troubling attempts at regulation.

Thank you for this opportunity to express our concerns about this dangerous legislation. The Alliance for Justice respectfully urges the Committee to take into ac-

count the risk this type of proposal creates for fundamental constitutional freedoms in the event it faces similar legislation in the future.

Sincerely,

JOHN POMERANZ  
Nonprofit Advocacy Counsel

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### Statement of OMB Watch

#### DISCLOSURE OF NONPROFIT POLITICAL ACTIVITY

OMB Watch is a 501(c)(3) tax-exempt organization that promotes greater citizen participation in pursuing a more accountable, responsive, and just government. To a large extent, we work with and through the nonprofit sector because of its vital place in our communities and our faith that the sector can play a powerful role to invigorate our democratic principles. OMB Watch works with nearly 10,000 nonprofits around the country—mostly 501(c)(3) organizations, but also 501(c)(4) organizations and unions—on various issues, including the protection of the nonprofit advocacy voice.

OMB Watch understands the potentially corrupting influence of money in politics, and recognizes the urgent need to revitalize public confidence in our democracy. Despite serious concerns about some of the recent suggestions for legislative action, we recognize the benefits of public disclosure of the sources of communications that are closely tied to candidates and elections, even if they fall short of the “express advocacy” standard permitting certain speech to be regulated and limited under the Federal Elections Campaign Act (“FECA”). A reporting scheme similar to that imposed on other nonprofit organizations would meet much of the legitimate public need for information about these entities.

As for more extensive regulation, we believe that “soft money” issues, including the problems raised by unlimited contributions to political parties, need to be addressed as part of a comprehensive approach to campaign finance reform. Focusing only on the advocacy activities of nonprofit organizations fails to address substantial problems throughout the existing campaign finance system.

As an initial matter, we note that nonprofit “political activities,” the subject of much discussion in Congress, may refer to a broad range of communications. Depending on context, “political” may describe spending that expressly supports the election or defeat of a candidate; discussions of candidates that fall short of such express advocacy; discussion of public policy issues conducted in the course of an election campaign that may have some effect on the outcome of the election; direct or grass roots lobbying with no electoral link; advocacy for or against a ballot measure; attempts to influence the nomination or confirmation of executive branch appointees; or even non-legislative policy advocacy. The distinctions between these categories of political speech are often far from clear, and it will help focus our discussion to acknowledge that they may be qualitatively different, and susceptible to differing constitutional analyses.

#### *Disclosure of Nonprofit Political Activities Should be Limited in Scope to Narrowly-Defined Activities*

OMB Watch recognizes the legitimate interest in public disclosure of spending intended to influence the outcome of elections, even when the communications fall short of expressly advocating the election or defeat of candidates. Public disclosure of candidate contributions as well as other electoral expenditures allows the electorate to make more informed voting decisions; public scrutiny of the sources of influence on policy makers are important to the government accountability OMB Watch is committed to. As described in greater detail below, we fully support extending to tax code section 527 groups the same level of disclosure that is applied under current law to other nonprofit organizations. More detailed disclosure of expenditures for electoral purposes may even be merited.

The interests of a free and vibrant democracy demand public accountability. But such accountability should not be advanced at the expense of freedom of association. Any disclosure requirements imposed on an organization that engages in political advocacy burden, to some extent, the exercise of First Amendment rights. In some circumstances the government’s legitimate interest in disclosure even of express advocacy is not sufficient to outweigh the administrative burden required to establish

a separate segregated fund for political campaign advocacy.<sup>1</sup> When the regulated speech falls short of express advocacy, the burden of detailed reporting is even more likely to be found to outweigh the public interest in disclosure.

Any attempt to regulate political speech, whether that of individuals or citizens' groups, must tread very carefully. Unless the boundaries of regulated speech are drawn both narrowly and precisely, forced disclosure and additional administrative burdens threaten to undermine well-recognized rights of citizens to associate freely and to engage in political advocacy without fear of reprisal. The existing definition of political activities under tax code section 527(e), for instance, is both unclear and overbroad. It includes not only communications that are primarily intended to promote a candidate, but also speech that may have an electoral effect without being clearly electoral on its face.

Still, let us assume for the moment that it is possible to define clearly a category of "electioneering" speech that falls just short of express advocacy. If the activity triggering the requirements is closely tied to speech that is clearly and unambiguously campaign-related, there is a strong governmental interest in requiring disclosure. Similarly, the more carefully the disclosure requirements are linked to the activity of concern, the less likely they are to infringe on other constitutionally protected speech. Unless a disclosure scheme is based on a carefully and narrowly crafted definition of electioneering speech, its reach is likely to be unconstitutionally vague or over broad.

There are indeed many organizations that take advantage of existing legal rules to engage in advocacy falling just short of "express," yet is clearly intended and is understood to serve as an electioneering message. In principle, there may be no constitutional impediment to disclosure requirements limited to these candidate-related electoral communications falling just short of express advocacy. In practice, however, the goal of forcing disclosure of advocacy closely tied to electioneering without impermissibly burdening citizens' rights to engage in advocacy on issues may prove elusive.

#### *Donor Disclosure Has the Potential to Substantially Burden First Amendment Rights*

Many proposals have been put forward that would require disclosure of identifying information about contributors to organizations that engage in political advocacy (variously defined). Yet, mandating disclosure of the identity of donors to nonprofit organizations raises troubling implications for free association and speech.

By banding together to speak collectively, members and supporters of nonprofit organizations enhance the exercise of their free speech rights. Particularly when addressing controversial issues, such organizations play a critical role in permitting effective advocacy. Viewpoints that might otherwise go unvoiced can compete in the "marketplace of ideas," and be evaluated on their merits. It is a fundamental tenet of this country's commitment to free speech that allowing many ideas to be heard and considered is inherently beneficial. Any action that would inhibit the expression of ideas should only be taken if it advances a truly compelling countervailing interest, and should be narrowly focused to limit as little speech as possible.

Privacy is an essential element of free association, a right closely linked to free speech. Forced disclosure of membership in (or financial support of) nonprofit organizations substantially burdens the members' right to speak out on issues of public importance. It is an obstacle to the freedom of association which becomes the mechanism for the exercise of free speech.

Congress has historically recognized the importance of shielding most nonprofit donor information from public disclosure. Section 501(c) organizations must report certain donor information to the IRS as part of their exemption applications and annual tax filings. Those documents must be made publicly available, but the names and addresses of donors are excluded from public disclosure.<sup>2</sup> The constitutional dimension of donor disclosure was most notably set out in *NAACP v. Alabama*,<sup>3</sup> which recognized the right of organizational members to join together to advocate on issues without revealing their individual identities. Subsequently, the Court in *Buckley v. Valeo* recognized the potential that donor disclosure has for infringing on First Amendment rights. (4) The record keeping, reporting, and donor disclosure requirements imposed by FECA on candidates and political committees were upheld only after a finding that they furthered government interests that were both significant and substantially related to the information required to be disclosed.

<sup>1</sup> *FEC v. Massachusetts Citizens for Life*, 479 U.S. 238, 252–255 (1986) (hereinafter MCFL).

<sup>2</sup> *E.g.*, 26 U.S.C. §§ 6104(b), 6104(d)(3)(A).

<sup>3</sup> 357 U.S. 449 (1958).

<sup>4</sup> 424 U.S. 1, 64 (1976).

Any attempt to mandate the disclosure of donors to nonprofit organizations must be evaluated in light of this standard. Requiring disclosure of contributions earmarked for narrowly-defined electioneering communications would probably be tailored to achieve the goal of making public information about what is perceived as “surreptitious” campaign spending. On the other hand, a requirement of the disclosure of all donors if an organization engages, as any part of its activity, in certain types of advocacy, sweeps far broader, imposes a greater burden on associational rights, and effectively penalizes groups for engaging in political speech at the core of the First Amendment’s protections.

*Itemized Expenditure Disclosure Does Little to Further the Public Interest in Accountability*

Disclosure of itemized expenditures, either of an entire organization or for particular activities, raises similar First Amendment concerns. Mandating disclosure of the identity of those who receive payments from an organization could include potentially private information, such as employee reimbursements. As was recognized in *Brown v. Socialist Workers ’74 Campaign Committee*,<sup>5</sup> it is not only those who contribute to or join organizations representing unpopular causes who may be subject to harassment or intimidation; those who choose to do business with such groups may be targeted because of that connection as well. While disclosing which office supply store an entity patronizes is unlikely to have negative ramifications, the clients of individual consultants or small firms may very well reflect the consultant’s political convictions. Working with a controversial organization is sometimes not just an economic statement.

Further, is it unclear what interest highly detailed, itemized reporting of expenditures would serve. Even if the only burden on the exercise of free speech rights is the additional administrative hassle of tracking and reporting expenditures in detail, the burden on the organization must correlate to an important public interest. It is highly questionable that the public’s ability to evaluate political speech would be meaningfully advanced by knowing the identity of the media consultant who helped an organization buy air time for an advertisement.

In upholding FECA’s disclosure requirements for independent expenditures, the Buckley Court suggested such requirements, if applied to an organization not operated primarily for political purposes, would be unconstitutionally over broad if extended to communications short of express advocacy. Thus, an expenditure disclosure scheme that applies to more broadly defined political speech must be carefully tailored to advance a compelling interest in disclosure. In addition to constitutional concerns, prudent policy suggests that potentially burdensome reporting requirements should not be imposed unless they are reasonably expected to provide a level of information that is useful to the public. Itemized expenditure reporting does not lead to significantly more useful information than can be obtained from reporting of general categories of expenses.

In any case, it does not make sense to require detailed disclosure of expenditures for “political” activities unless the same requirement applies to all such expenditures by any entity. The public interest in obtaining information about political expenditures by nonprofit organizations is no greater than the interest in similar information about such activities by for-profit companies. If there is indeed a legitimate public need to know who paid whom how much to undertake specific political advocacy, it applies equally to all entities.

*Disclosure Limited to 527 Organizations Raises Problems of Public Confusion and Inconsistency*

Some proposals would limit their scope to entities exempt from taxation under section 527 that are not required to register and report under FECA. These organizations are by definition “operated primarily for the purpose of directly or indirectly . . . influencing or attempting to influence” elections to public office.<sup>6</sup> By limiting its reach to these political organizations, this approach minimizes its infringement of donors’ rights; a contributor to a 527 organization is at least on notice that she is supporting an organization involved in election-related advocacy.

In addition, this approach has the merit of addressing an unintended gap in existing reporting and disclosure laws. As discussed below, OMB Watch supports imposing registration and reporting requirements on 527 organizations similar to those for other nonprofit organizations. However, a more comprehensive disclosure regime limited to 527 organizations raises difficult issues.

<sup>5</sup> 459 U.S. 87, 96–98 (1982)

<sup>6</sup> 26 U.S.C. § 527(e)



In recent years, IRS rulings have progressively extended the reach of activities covered by section 527(e).<sup>7</sup> This definition covers not only those communications that barely escape regulation by the Federal Election Commission (FEC), but also a wide array of issue advocacy that may only indirectly affect a candidate election. There must be a nexus to elections, but the link may be slight, and may not be evident on the face of a communication. The electoral connection may only be revealed upon close inspection of internal documents demonstrating the organization's intent in decisions regarding geographic targeting or message development.

Rulings have found that 527 activities may encompass grassroots lobbying communications; mass media advertisements that do not identify specific legislators; ballot measure activities; and litigation. In many cases, the determination that these activities are "political" rests on evidence of subjective intent found only in internal records.<sup>8</sup> The contents of a communication may not overtly be linked to an election, but decisions made about targeting and distribution bring it into 527's ambit. The breadth of the IRS interpretation of 527(e) demonstrates a fact that courts in election law cases have repeatedly recognized: advocacy of issues and advocacy for or against candidates are often inextricably intertwined. Some 527 activity may be indistinguishable to the outside observer from pure issue advocacy activities conducted by 501(c)(4), or even 501(c)(3), nonprofit organizations.<sup>9</sup> We therefore believe that imposing detailed donor disclosure requirements on only one type of organization would lead to both inconsistency and public confusion.

Furthermore, to the extent section 527 organizations engage in advocacy that reaches much further than a narrowly drawn category of almost-express advocacy, forced donor disclosure implicates the same constitutional concerns raised in *NAACP v. Alabama*. Citizens choose to maintain individual anonymity and engage in political advocacy through support of organizations for a variety of legitimate reasons. Their right to do so should not be abridged absent compelling countervailing concerns. Including all 527 organizations with their entire range of advocacy activities is not sufficiently narrowly tailored to the interest in providing the public with information about campaign expenditures to offset the infringement on their supporters' right to privacy in their political associations.

#### *Extending Disclosure to Other Organizations is Even More Problematic*

Other proposals would impose disclosure obligations on organizations that engage in covered "political" activity regardless of the type of organization. While this approach avoids the logical inconsistency of different disclosure requirements for organizations whose activities may appear indistinguishable, it does so at the expense of the First Amendment rights of supporters of organizations not organized primarily for electoral purposes. Requiring disclosure of donors who support the general activities of a nonprofit organization because that organization chooses to engage in legally permissible political advocacy effectively penalizes the exercise of free speech. Extending any disclosure requirement beyond donations earmarked for communications closely linked to candidates and elections invades donors' associational rights without furthering a compelling public interest substantially related to the required disclosure.

There may be many reasons that individual donors would not want their support of an organization to become public knowledge. Contemporary issues, like public opinion and public tolerance for dissent, change swiftly. Even issues that are not unpopular today may one day become highly controversial. A disclosure system that makes public lists of individuals supporting various causes creates a potentially chilling legacy. We need only recall to the McCarthy era to realize the potential for misuse of such information.

Some have suggested the harsh effects of donor disclosure requirements could be ameliorated by permitting an organization to establish a separate fund for covered "political" activities, and limit disclosure to contributors to that fund. This modification slightly reduces the infringement on free association, but it nonetheless establishes a significant burden on organizations wishing to engage in issue advocacy in

<sup>7</sup>In fact, section 527 sweeps more broadly than expenditures directly and indirectly related to candidate elections, and may include some activities which even 501(c)(3) organizations may undertake, such as seeking to influence nomination and Senate confirmation of Executive branch appointees. We assume for purposes of this discussion that non-electoral 527 organizations and activities could somehow be carved out from the scope of any legislation, although this could be difficult.

<sup>8</sup>E.g., Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999).

<sup>9</sup>For example, 501(c)(3) organizations may support or oppose referenda, which would be counted under its permissible lobbying activities. Unlike the 527 group, the 501(c)(3) is engaged to influence the policy, not an election. In this case, the difference between the two groups is one of intent, not action—and therefore indistinguishable to the public.

the context of a political campaign. However, the administrative burden of maintaining a segregated account and separately raising funds for certain advocacy activities should not be underestimated.

Requiring such specific earmarking in raising funds for different advocacy activities creates many difficulties. Donors typically give to support an organization's mission, trusting the nonprofit to use the funds as best it can to achieve those ends. Dividing the organization's activities into two (or more) pools requires that contributions be earmarked for one or the other. Rather than deciding on a day-to-day basis which activities best further the group's mission, funded by donors who support that mission, a nonprofit must solicit in advance specific contributions for specific activities. Donors are deprived of the ability to effectively provide general support for the organization. Any sort of earmarking scheme requires complex administration that reduces flexibility and impedes the ability to conduct program activities. Especially for an organization with a broad donor base, asking each contributor to designate the activities to be supported with her contribution creates a tremendous barrier to operating a unified organization.

The tax code already provides for creation of separate segregated funds for nonprofits to engage in political activity.<sup>10</sup> Creating such a fund allows an organization to avoid taxation of its investment income. The administrative burden of operating through such a fund does not offset the tax penalty of conducting political activities directly. A legislative proposal that would set donor privacy as the additional price of not administering a segregated fund for political activities seriously impedes the exercise of First Amendment rights. The administrative burden of establishing a PAC under the election law played a role in the determination that a ban on independent express advocacy by corporations violated MCFL's First Amendment rights.<sup>11</sup> Requiring a separate fund for political advocacy defined more broadly than express advocacy as the price of protecting donor privacy raises serious constitutional issues.

It is important to recognize that existing FCC regulations already require that an organization making a communication via paid broadcast advertising identify itself. The print media, as a matter of policy, generally require identification of the sponsor of paid ads. Mandating disclosure of that organization's supporters may add incrementally to the information available to the public in evaluating its message, but only at the expense of a significant infringement on associational rights. Established nonprofit organizations are generally known to the public; their agenda is understood, and their position can be weighed accordingly. The public can also weigh the credibility of organizations that do not have an established reputation, or that represent only a small group of donors. The incremental benefit of public disclosure of donors to organizations that may only incidentally engage in political campaign advocacy does not support invading their supporters' privacy, associational, and speech rights.

We also note the difficulty of defining appropriately covered activity. Several legislative proposals that have made an activity the trigger for disclosure rather than the type of organization have sought to capture communications that fall short of express advocacy, yet are sufficiently closely tied to candidates and elections to merit regulation. Yet in attempting to draw a bright line to give regulated entities adequate notice of covered activities, these definitions have inevitably swept too broadly.

For instance, grassroots lobbying communications with no electoral intent (or effect) whatsoever must necessarily identify legislators whom the public is urged to contact regarding legislation. Yet legislators are frequently candidates. Distinguishing genuine lobbying messages from those that use legislation as an excuse to tarnish a candidate's character is no simple task. Indeed, some bills proposed would require disclosure of individual donors for organizations that make communications that do not even constitute political advocacy. Some of these proposals cover communications that "mention an individual holding Federal office or a clearly identified candidate for election for Federal office." Yet this definition includes not only lobbying messages, but even a public service announcement that features a well-known public figure and office holder encouraging screening for a particular health risk. Even if it is constitutionally possible to impose disclosure requirements on organizations based on participation in certain activities, the net should not be cast so wide as to capture non-electoral, or even wholly non-political, communications.

We are also concerned that disclosure requirements imposed on activities that are entirely non-electoral would inevitably be extended to 501(c)(3) organizations. While 501(c)(3) charities may be exempted from disclosure initially, the inconsistency of

<sup>10</sup> 26 U.S.C. § 527(f)(3).

<sup>11</sup> 479 U.S. at 252–255.

a disclosure regimen triggered by advocacy of 501(c)(4), 501(c)(5), or 501(c)(6) organizations but not by similar advocacy by 501(c)(3)s will inevitably generate pressure to eliminate this inequity. If an election campaign disclosure measure is to avoid the risk of being extended to entities that are prohibited from engaging in campaigns, it must regulate only unambiguously electoral activity.

#### *Appropriate Disclosure for 527 Organizations*

Despite serious concerns about the potential scope of some of the proposals for donor disclosure related to political activities, OMB Watch does believe there is a need to address the legal anomaly that imposes no registration or reporting requirements on 527 organizations that fall outside the authority of the FEC. The form 1120-POL currently filed by these organizations does not provide sufficient information to evaluate them. However, the existing tax code framework for disclosure of other nonprofit organizations should, with a few modifications, serve to provide sufficient information to allow greater public understanding of these currently unregulated entities.

Most 501(c) tax-exempt entities must file Form 990 with the IRS on an annual basis. They provide information about their financial condition, program activities, revenues, expenditures, names of officers and directors, and compliance with various legal restrictions. It certainly makes sense to extend this type of reporting scheme to 527 organizations, so that the different types of tax exempt organizations are subject to similar tax reporting requirements.

Additionally, 527 organizations should file a registration statement with the FEC upon their formation to provide the news media and members of the public with notice of its existence. The press has uncovered the existence of a number of 527 organizations even under current law, allowing the public to judge their communications accordingly. Mandating publicly available registration of all 527 groups would go far to shedding the light of public scrutiny on their activities.

The information contained on a 990-style filing would provide a reasonable basis for the public to evaluate an entity sponsoring political advocacy activities, as it does for other nonprofit organizations. While individual donor identities are not subject to public disclosure, the form provides an overall picture of the organization's sources of support, financial situation, and activities. Similarly, the 990 requires reporting expenditures by category, rather than itemized detail. Surely the public interest in disclosure would be served by knowing the breakdown of funds spent on media buys, message development, staff, overhead, and fundraising costs; permitting an examination of each entry in a check register does not add a meaningful degree of public accountability.

It might be appropriate to consider for 527s some modifications from the information required on the basic Form 990. Just as 501(c)(3)s must file Schedule A containing more detailed information considered particularly significant in evaluating their legal compliance, 990-style disclosure by 527s need not be strictly limited to the exact items required of 501(c)(4)s, 501(c)(5)s, or 501(c)(6)s. A supplemental schedule could provide additional information helpful to the public in evaluating 527 entities.

One significant concern that has been raised about 527s is that they may represent the interests of only a small group of individuals, yet operate under a name that deceptively suggests they are organized to promote the public interest. It is not necessary to reveal the identities of individual donors to notify the public that these entities do not in fact represent a broader community. A measure similar to that used by 501(c)(3)s to demonstrate "public support" can indicate whether an organization receives broad public support or is likely to represent the interests of a small group of donors. Armed with this information, the public can evaluate the credibility of an organization's statements and the likelihood that it is seeking to advance a private agenda.

In some cases, it may be appropriate to require individual disclosure of large expenditures. For instance, consultants may play a significant role in developing an organization's program activities. Just as the identity and compensation of officers, directors or key employees is disclosed on the 990, the identity of consultants (perhaps those compensated over a certain amount) can be important in determining the entity's agenda. Thus, just as 501(c)(3)s must disclose on Schedule A payments to consultants over \$50,000, similar disclosure for 527 organizations, or for expenditures by other organizations undertaking 527 activities, may increase public accountability.

The annual 990 submission may present two special problems when extended to 527 groups. First, an annual submission is not timely, particularly in the context of disclosure about actions to influence the outcomes of an election. To solve this problem, we think 527 groups making expenditures above a specific threshold

should be required to report on a quarterly basis. This reporting should be done electronically to insure immediate and accurate disclosure.

Second, the IRS is not structured to provide immediate release of information and is chronically underfunded in its tax-exempt enforcement area. Accordingly, we suggest that 527 groups should not only submit the 990 filing to the IRS, but also to the FEC. The FEC is more adequately prepared to provide prompt public access to information.

We believe this type of disclosure—absent donor disclosure—can greatly enhance public accountability. Admittedly, it is not perfect. It may still be difficult to determine the extent to which a 527 organization is candidate controlled, even with disclosure of directors. It will not provide detailed FEC-type disclosure for communications falling just short of express advocacy but having nearly the same impact. But, as described earlier, we do not believe it is possible to create a bright line test of such activity without trampling on constitutional rights.

Despite these limitations, our suggestions would allow the public to take notice of a newly registered 527 group. If the public contacts the newly registered group and they choose not to disclose certain information, that refusal may have some impact on the credibility and legitimacy given to the group's message. Combined with information from the 990, the public will be armed with information to hold the 527 group accountable, yet core constitutional principles will not be violated.

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**Statement of Hon. Greg Walden, a Representative in Congress from the  
State of Oregon**

Mr. Chairman, I appreciate this opportunity to add my voice to the debate surrounding the reform of American campaign financing laws, particularly as it relates to the disclosure requirements of tax-exempt organization. While few campaign finance proposals are raised without controversy, I believe the full disclosure of campaign funds is a reform that will enhance the accountability of those who seek to influence our elections without subtracting from the freedom of the American people. Unlike most campaign finance reforms, which consist principally of allowing politicians to ration the amount of money that can be spent on their campaigns for reelection, this proposal simply requires these organizations to reveal the sources of their donations.

Mr. Chairman, a number of reforms have been proposed to mitigate the influence of special interest money in politics, foremost among these the ban on unregulated, or "soft" money, which is sent to political parties and not individual candidates. These donations, while ostensibly intended for "party building" activities, often are used to fund issue advocacy advertisements that are no less effective than those purchased by "hard" money, which are strictly regulated. Chief among the complaints by campaign finance proponents is that the absence of donor limitations gives the wealthy disproportionate influence in the political process over those with lower incomes. And while banning soft money completely is attractive to many, others argue that limitations on political contributions represent unconstitutional assaults on the free speech rights of the American people.

Like most lawmakers, I favor campaign finance reform that diminishes the ability to influence the American electoral process in unseemly ways without compromising the First Amendment. The most obvious and effective campaign finance reform, of course, would be to scale back the intrusiveness of the federal government. If the various laws and regulations emanating from Congress and the federal agencies were not so inextricably tied to Americans' livelihood, their desire to influence the government with campaign contributions would be significantly reduced. Under the current system, however, citizens and businesses simply have no choice but to involve themselves in the political process because of the degree to which the government attempts to mold the landscape of American life.

And while scaling back the size of government is a goal to which Republicans in Congress have committed themselves, no fundamental changes in government can take place with the swiftness that is needed to address the flaws in our campaign finance system. Among the immediate proposals I support to cleanse our campaign finance system, there is no need more obvious than that of full disclosure laws. Organizations that are afforded special tax-exempt status by our laws should not enjoy the ability to influence elections while remaining shielded from the scrutiny of the American people.

I believe that like political candidates and political action committees (PACs), tax-exempt organizations that make financial contributions should be required to disclose fully the sources of their funds. Furthermore, the officers of such organizations

should be made known to the public, in addition to other reasonable requirements deemed necessary to ensure the American people know who is influencing the political process.

The explosion of technology—particularly the Internet—has afforded us the remarkable opportunity of having near-instant disclosure of campaign donations. While I believe donating to political candidates or grass-roots organizations is a fundamental American right, and one that should not be discouraged, I am equally convinced that disclosing the sources of these contributions will provide for an electoral system that is cleaner and less susceptible to corruption.

Thank you, Mr. Chairman.

